



# Notices to Members

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# Notice to Members

JULY 2003

## SUGGESTED ROUTING

Legal and Compliance  
Senior Management  
Operations  
Trading and Market Making

## KEY TOPICS

Electronic Communications  
Communications with the Public  
Recordkeeping

## INFORMATIONAL

### Instant Messaging

Clarification for Members Regarding Supervisory Obligations and Recordkeeping Requirements for Instant Messaging

### Executive Summary

NASD is clarifying for members their supervisory obligations and recordkeeping requirements with respect to instant messaging.

### Questions/Further Information

Questions concerning this *Notice* may be directed to Mary Sue Fisher, Special Counsel, Regulation Policy, Department of Member Regulation at 202-728-8277, or Thomas A. Pappas, Associate Vice President, Advertising Regulation at 240-386-4553.

### Background

The Securities and Exchange Commission (SEC) issued key releases in 1996 and 1997 that guide the use of electronic media by broker/dealers. The first release discussed the use of electronic media to deliver information to customers (Electronic Delivery Release); the second described the application of recordkeeping requirements to electronic communications (Electronic Records Release).<sup>1</sup> Although electronic communications technology has evolved rapidly in the intervening years, these releases established a basic principle that underlies current regulatory policy. The SEC stated in the Electronic Delivery Release that:

SRO rules concerning the supervisory requirements for electronic communications should be based on the content and audience of the message, and not merely the electronic form of the communication.<sup>2</sup>

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The Electronic Records Release extended that principle to broker/dealer record-keeping requirements, prescribing that:

[f]or record retention purposes under Rule 17a-4, the content of the electronic communication is determinative, and therefore broker/dealers must retain only those e-mail and Internet communications (including inter-office communications) which relate to the broker/dealer's "business as such."<sup>3</sup>

NASD has followed these precepts in adopting, amending, and interpreting NASD rules governing communications with customers and the public (2200), suitability (2310), research analysts and reports (2711), supervision (3010), and books and records (3110). These rules accord members flexibility to use a variety of approaches, including innovative technologies, if their use is subject to an effective program of supervision and complies with applicable recordkeeping requirements.

### Communications with the Public

NASD recognizes that evolving technologies may offer multiple functions that do not fit neatly into traditional supervisory categories. NASD therefore published the *Internet Guide for Registered Representatives* to assist registered representatives and firms in their use and supervision of electronic communications with the public.<sup>4</sup> The *Internet Guide* first lays out the general compliance requirements that apply to all forms of communication with the public; it then discusses how specific types of electronic media fit within existing supervisory categories. For example, the *Internet Guide* treats group e-mail as "sales literature,"<sup>5</sup> individual e-mail as "correspondence," publicly

available Web sites as "advertisements," and chat-room discussions as "public appearances."

NASD developed the *Internet Guide* relying on the same basic principles established in the SEC's Electronic Delivery and Electronic Records Releases: the content and audience of each type of electronic communication determine the appropriate supervisory and recordkeeping treatment. These principles also form the basis of the "facts and circumstances" test adopted by NASD in its policy statement concerning online suitability.<sup>6</sup>

### Instant Messaging

Instant messaging is a developing technology that can pose supervisory and recordkeeping challenges for member firms. Instant messaging alerts users when other users are online and enables those users to communicate in real time. Instant messaging was originally introduced as an add-on to subscription Internet services, but has a growing presence in business communication. Consumer versions of instant messaging did not provide business users with tools to monitor or archive instant messaging communication. Many firms determined that they could not adequately supervise instant messaging communications and banned the use of instant messaging for communication with the public.

Other firms have allowed use of instant messaging, reasoning that instant messaging is less formal than e-mail and paper-based communication and need not be subject to the same requirements. However, lack of formality of instant messaging does not exempt it from the general standards applicable to all forms of communication with the public. Members should evaluate instant

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messaging according to the “content and audience” of the instant messaging communications.

Members must supervise the use of instant messaging consistent with the required supervision of e-mail messaging. Depending on the circumstances, instant messaging could be either sales literature or correspondence.<sup>7</sup> Compliance in each of these situations depends on clear supervision and review procedures that are consistently followed.<sup>8</sup> If a member is unable to establish an adequate supervisory program, the member must prohibit the use of instant messaging in customer communication.<sup>9</sup>

Members must also ensure that their use of instant messaging complies with applicable SEC and NASD recordkeeping requirements. Messages exchanged on many popular instant messaging platforms cannot be saved or subsequently retrieved, making them inappropriate for communications that must be retained as firm records. Members that permit instant messaging must use a platform that enables the member to monitor, archive, and retrieve message traffic.

## Internal Communications and Recordkeeping Requirements

NASD Rule 3010 requires

each member to establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with [NASD] Rules....

NASD rules do not specifically require member firms to review or approve internal communications. However, members must be certain that they have

procedures adequate to supervise the activities of each registered representative and associated person, including their use of electronic communications technology.

Members must also assure themselves that their use of electronic communications media enables them to make and keep records, as required by SEC Rules 17a-3, 17a-4, and NASD Rule 3110. Recent SEC and NASD enforcement actions serve as a forceful reminder that

Rule 17a-4 is not limited to physical documents.... [I]nternal e-mail communications relating to a broker or dealer’s “business as such” fall within the purview of Rule 17a-4.<sup>10</sup>

SEC Rule 17a-4(b)(4) and NASD Rule 3110

require firms to preserve for a period of not less than three years, the first two years in an easily accessible place, originals of all communications received and copies of all communications sent by the firm or its employees relating to its business. Those rules apply to electronic communications....<sup>11</sup>

NASD urges members to evaluate their internal use of instant messaging in light of their supervisory and recordkeeping requirements. NASD recognizes that technology enhances business opportunities, increases public access to market information, and supports regulatory compliance. Nonetheless, the preference of employees to use instant messaging to communicate does not alter the obligation of the firm to keep relevant records. NASD members must ensure that their use of instant messaging is consistent with their basic supervisory and recordkeeping obligations.

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## Endnotes

- 1 SEC Release No. 34-37182 (May 1996) (Electronic Delivery Release); SEC Release No.34-38245 (Jan. 1997) (Electronic Records Release).
- 2 Electronic Delivery Release at 5.
- 3 Electronic Records Release at 16.
- 4 The *Guide* is available on the NASD Web Site at <http://www.nasdr.com/4040.asp>.
- 5 The treatment of group e-mail will be modified by amendments to Rule 2210, approved by the SEC on May 9, 2003. See, SEC Release No. 34-47820 (May 9,2003), 68 Fed. Reg. 27116 (May 19, 2003). The amended definition of "correspondence" in Rule 2210 includes any written letter or electronic mail message distributed by a member to one or more existing retail customers and fewer than 25 prospective retail customers within a 30-day period. The rule change takes effect on November 3, 2003. In the interim, NASD has taken a no-action position with respect to group e-mail sent to institutional accounts, provided that the e-mail is subject to the same supervisory system as individual correspondence. See, Letter from Alden S. Atkins, General Counsel, NASD Regulation to Yoon-Yung Lee, Wilmer, Cutler & Pickering, (Dec. 7, 1999) available at [http://www.nasdr.com/2910/2210\\_07.asp](http://www.nasdr.com/2910/2210_07.asp).
- 6 *NASD Notice to Members 01-23*.
- 7 See, note 5 for a discussion of recently approved amendments to Rule 2210.
- 8 The essential elements of the supervisory program are discussed in *NASD Notice to Members 98-11*.
- 9 *Id.* *Notice to Members 98-11* states that supervisory policy and procedures must "prohibit registered representatives' and other employees' use of electronic correspondence to the public unless such communications are subject to supervisory and review procedures developed by the firm. For example, [NASD] would expect members to prohibit correspondence with customers from employees' home computers or through third party systems unless the firm is capable of monitoring such communications."
- 10 See, *In Re Deutsche Bank Securities, Inc., Goldman, Sachs and Co., Morgan Stanley & Co. Incorporated, Salomon Smith Barney, Inc., U.S. Bancorp Piper Jaffray Inc., Letter of Acceptance, Waiver and Consent No. CAF020064* (Nov. 2002) p.5.
- 11 See, *In Re Robertson Stephens*, Letter of Acceptance, Waiver and Consent No. CAF030001 (Jan. 2003) p. 12.

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# Notice to Members

JUNE 2003

## SUGGESTED ROUTING

Legal and Compliance  
Operations  
Registration  
Senior Management

## KEY TOPICS

Anti-Money Laundering  
Compliance Programs

## INFORMATIONAL

### Anti-Money Laundering Customer Identification Programs for Broker/Dealers

Treasury and SEC Issue Final Rule Regarding Customer Identification Programs for Broker/Dealers; **Effective Date: October 1, 2003**

#### Executive Summary

On April 30, 2003, the Department of Treasury (Treasury) and the Securities and Exchange Commission (SEC or Commission) jointly issued a final rule to implement Section 326 of the USA PATRIOT Act (PATRIOT Act).<sup>1</sup> Section 326 provides that Treasury and SEC issue a rule that, at a minimum, requires broker/dealers to implement reasonable procedures to: (1) verify the identity of any person seeking to open an account, to the extent reasonable and practicable; (2) maintain records of the information used to verify the person's identity; and (3) determine whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to brokers or dealers by any government agency. The final rule requires each broker/dealer to establish a written Customer Identification Program (CIP) to verify the identity of each customer who opens an account. The written CIP must also include recordkeeping procedures and procedures for providing customers with notice that the broker/dealer is requesting information to verify their identity. Broker/dealers must fully implement their CIPs by October 1, 2003.

#### Questions/Further Information

Questions regarding this *Notice to Members* may be directed to Kyra Armstrong, at (202) 728-6962, or Vicky Berberi-Doumar, at (202) 728-8905, both of the Department of Member Regulation; or Nancy Libin, at (202) 728-8835, or Grace Yeh, at (202) 728-6939, both of the Office of General Counsel, NASD Regulatory Policy and Oversight.

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## Background

On October 26, 2001, President Bush signed into law the PATRIOT Act. Title III of the PATRIOT Act imposed obligations on broker/dealers under new anti-money laundering (AML) provisions and amendments to the Bank Secrecy Act (BSA) in an effort to make it easier to prevent, detect, and prosecute money laundering and the financing of terrorism. Among these obligations, broker/dealers were required to have an AML compliance program in place as of April 24, 2002. Consistent with this requirement under the PATRIOT Act, NASD Rule 3011 requires each member, to develop and implement a written AML program reasonably designed to achieve and monitor the member's compliance with the requirements of the BSA and the implementing regulations.

On July 23, 2002, Treasury and the SEC jointly proposed a rule to implement Section 326 of the PATRIOT Act with respect to broker/dealers. The SEC received 20 comment letters in response to the proposal. Members of the industry questioned, among other things, the proposed rule's definition of "customer," which included persons with trading authority over an account. Others expressed concern about the verification and recordkeeping requirements. The final rule addresses many of the comments.

## Description of Final Rule

### *Relevant Definitions*

The final rule provides several definitions, which, among other things, assist members in determining who are the relevant persons whose identities need to be verified.

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**1. Account.** The final rule defines an “account” as a formal relationship with a broker/dealer established to effect transactions in securities, including, but not limited to, the purchase or sale of securities, securities loaned and borrowed activity, and the holding of securities or other assets for safekeeping or as collateral.<sup>2</sup>

Importantly, the final rule contains two exclusions from the definition of “account.” The definition excludes: (a) an account that the broker/dealer acquires through any acquisition, merger, purchase of assets, or assumption of liabilities;<sup>3</sup> and (b) an account opened for the purpose of participating in an employee benefit plan established under the Employee Retirement Income Security Act of 1974 (“ERISA”).<sup>4</sup>

The Adopting Release explains that in acquisitions, mergers, purchases of assets, or assumptions of liabilities, customers do not initiate these transfers and, therefore, the accounts do not fall within the scope of Section 326 of the PATRIOT Act.<sup>5</sup>

In addition, transfers of accounts that result from an introducing broker/ dealer changing its clearing firm would fall within this exclusion.<sup>6</sup>

As initially proposed, the definition of “account” contained several examples of types of accounts that would be covered including cash accounts, margin accounts, prime brokerage accounts, and accounts established to engage in securities repurchase transactions. The Adopting Release notes that these types of accounts remain “accounts” for purposes of the final rule, but the final rule does not specifically include them as examples to clarify that the list is not exhaustive.

**2. Broker/dealer.** “Broker/dealer” is defined as a person registered or required to be registered as a broker or dealer with the Commission under the Securities Exchange Act of 1934 (Exchange Act) except persons who are required to be registered solely because they effect transactions in security futures products.<sup>7</sup>

**3. Customer.** The final rule defines “customer” as: (a) a person that opens a new account; and (b) an individual who opens a new account for an individual who lacks legal capacity or for an entity that is not a legal person.<sup>8</sup>

Under this definition, “customer” does not refer to persons who fill out account opening paperwork or who provide information necessary to set up an account, if such persons are not the accountholder as well.

In addition, the Adopting Release addresses concerns about identity verification in situations involving trust and omnibus accounts. The release explains that a broker/dealer is not required to look through a trust or similar account to its beneficiaries, and is required only to verify the identity of the named accountholder.<sup>9</sup> Similarly, with respect to an omnibus account established by an intermediary, a broker/dealer is not required to look through the intermediary to the underlying beneficial owners, if the intermediary is identified as the accountholder.<sup>10</sup>

As noted above, the proposed rule required that the broker/dealer verify the identity of those with trading authority over an account. The final rule, however, does not include persons with trading authority over accounts in the definition of “customer.” Accordingly, the broker/ dealer does not have to verify those

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individuals' identities. However, the final rule recognizes that situations may arise where a broker/dealer will have to take extra steps to verify the identity of those with trading authority. In these instances, a CIP is required to address situations where the broker/dealer will take additional steps to verify the identity of a customer that is not an individual by seeking information about individuals with authority or control over the account in order to verify the customer's identity.<sup>11</sup>

The final rule's definition also contains additional exclusions. The following entities are excluded from the definition of "customer":

- ♦ A person that has an existing account with the broker/dealer, provided the broker/dealer has a reasonable belief that it knows the true identity of the person;
- ♦ A financial institution regulated by a Federal functional regulator (the definitions of which are discussed below in numbers 4 and 5 of this section);
- ♦ Banks regulated by a state bank regulator;
- ♦ A department or agency of the United States, of any State, or of any political subdivision of any State;
- ♦ Any entity established under the laws of the United States, of any state, or of any political subdivision of any state, or under an interstate compact between two or more states, that exercises governmental authority on behalf of the United States or any such state or political subdivision; or
- ♦ Any entity, other than a bank, whose common stock or analogous equity interests are listed on the New York Stock Exchange or the American Stock Exchange or whose common stock or analogous equity interests have been designated as a NASDAQ National Market Security listed on The NASDAQ Stock Market (except stock or interests listed under the separate "NASDAQ Small-Cap Issues" heading), provided that, for purposes of this provision, a person that is a financial institution, other than a bank, is an exempt person only to the extent of its domestic operations.

**4. Federal functional regulator.** "Federal functional regulator" is defined as: the SEC; the Commodity Futures Trading Commission; the Board of Governors of the Federal Reserve System; the Office of the Comptroller of the Currency; the Board of Directors of the Federal Deposit Insurance Corporation; the Office of Thrift Supervision; or the National Credit Union Administration.<sup>12</sup>

**5. Financial Institution.** "Financial Institution" is defined to include: an insured bank (as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h))); a commercial bank or trust company; a private banker; an agency or branch of a foreign bank in the United States; an insured institution (as defined in section 401(a) of the National Housing Act, 12 U.S.C. 1724(a)); a thrift institution; a broker or dealer registered with the SEC under the Exchange Act; a broker or dealer in securities or commodities; an investment banker or investment company; a currency exchange; an issuer, redeemer, or cashier of travelers' checks, checks, money orders, or similar instruments; an operator of a credit card system; an

insurance company; a dealer in precious metals, stones, or jewels; a pawnbroker; a loan or finance company; a travel agency; a licensed sender of money; a telegraph company; a business engaged in vehicle sales, including automobile, airplane, and boat sales; persons involved in real estate closings and settlements; the United States Postal Service; an agency of the United States Government or of a state or local government carrying out a duty or power of a business described in this paragraph; a casino, gambling casino, or gaming establishment with an annual gaming revenue of more than \$1,000,000 which is licensed as a casino, gambling casino, or gaming establishment under the laws of any State or any political subdivision of any State; or is an Indian gaming operation conducted under or pursuant to the Indian Gaming Regulatory Act other than an operation which is limited to class I gaming (as defined in section 4(6) of such Act); any business or agency which engages in any activity which the Secretary of the Treasury determines, by regulation, to be an activity which is similar to, related to, or a substitute for any activity in which any business described in this paragraph is authorized to engage; or any other business designated by the Secretary whose cash transactions have a high degree of usefulness in criminal, tax, or regulatory matters.<sup>13</sup>

**6. Taxpayer identification number.**

"Taxpayer identification number" has the same meaning as determined under the provisions of Section 6109 of the Internal Revenue Code and the regulations of the Internal Revenue Service thereunder (e.g., social security number or employer identification number).<sup>14</sup>

**7. U.S. person.** "U.S. person" means a United States citizen or a person other than an individual (such as a corporation, partnership or trust) that is established or organized under the laws of a State or the United States.<sup>15</sup>

**8. Non-U.S. person.** "Non-U.S. person" means a person that is not a U.S. person.<sup>16</sup>

## Customer Identification Program

### *Minimum Requirements*

The final rule requires that broker/dealers establish, document, and maintain a written CIP. This program must be appropriate for the firm's size and business, be part of the firm's anti-money laundering compliance program, and, at a minimum, must contain procedures for the following: identity verification, recordkeeping, comparison with government lists, and providing customer notice.<sup>17</sup>

### *Required Customer Information*

A broker/dealer's CIP must contain procedures for opening an account that specifies the identifying information that will be obtained from each customer. The minimum identifying information that must be obtained from each customer prior to opening an account is:

- ◆ A name;
- ◆ A date of birth, for an individual;
- ◆ An address, which will be:
  - ◆ For an individual, a residential or business street address;

- ◆ For an individual who does not have a residential or business street address, an Army Post Office (APO) or Fleet Post Office (FPO) box number, or the residential or business street address of a next of kin or another contact individual; or
- ◆ For a person other than an individual (such as a corporation, partnership, or trust), a principal place of business, local office, or other physical location; and
- ◆ An identification number, which will be:
  - ◆ For a U.S. person, a taxpayer identification number; or
  - ◆ For a non-U.S. person, one or more of the following:
    - a taxpayer identification number;
    - a passport number and country of issuance;
    - an alien identification card number; or
    - the number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar safeguard.<sup>18</sup>

Treasury and the SEC adopted the required customer information provisions substantially as proposed with changes to accommodate individuals who may not have physical addresses. The Adopting Release notes that the minimum required information is collected by most broker/dealers already, is necessary for the verification process, and serves an important law enforcement function.

With respect to non-U.S. persons, the final rule contains some flexibility in the identification number requirement because a firm can choose from a variety of information numbers to accept from a non-U.S. person. In this regard, the Adopting Release states that there is no uniform identification number that non-U.S. persons would be able to provide to a broker/dealer. Nevertheless, whatever identifying information the firm does accept must enable the firm to form a reasonable belief that it knows the true identity of a customer.<sup>19</sup>

***Exception for Persons Applying for a Taxpayer Identification Number***

The proposed rule allowed broker/dealers to open an account for a new business that applied for, but had not received, a taxpayer identification number. The final rule expanded the exception in the proposed rule to include natural persons who have applied for, but not received, a taxpayer identification number. Therefore, instead of obtaining a taxpayer identification number from a customer (either natural or non-natural) prior to opening an account, a CIP may include procedures for opening an account for a customer that has applied for, but has not received, a taxpayer identification number. In this case, the CIP must include procedures to confirm that the application was filed before the customer opens the account and to obtain the taxpayer identification number within a reasonable period of time after the account is opened.<sup>20</sup>

***Identity Verification Procedures***

A CIP must include risk-based procedures for verifying the identity of each customer to the extent reasonable and practicable. The procedures must enable the broker/dealer to form a reasonable

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belief that it knows the true identity of each customer. The procedures must be based on the broker/dealer's assessment of the relevant risks, including those presented by the:

- ▶ types of accounts maintained by the broker/dealer;
- ▶ methods of opening accounts provided by the broker/dealer;
- ▶ types of identifying information available; and
- ▶ broker/dealer's size, location, and customer base.<sup>21</sup>

#### **Customer Verification**

A CIP must contain procedures for verifying the identity of each customer, using the required information described above, within a reasonable time before or after the customer's account is opened.<sup>22</sup>

The final rule and Adopting Release do not define "reasonable time." The Adopting Release states that "[t]he amount of time may depend on the type of account opened, whether the customer opens the account in-person, and the type of identifying information available."<sup>23</sup>

A broker/dealer's CIP is required to include procedures that describe when the broker/dealer will use documentary methods, non-documentary methods, or a combination of both methods to verify customers' identities. For example, depending on the type of customer, the method of opening an account, and the type of identifying information available, it may be more appropriate to use either documentary or non-documentary methods, and in some cases it may be appropriate to use both methods. These procedures should be based on the firm's

assessment of the relevant risk factors discussed above.<sup>24</sup>

#### **Verification through documents**

The final rule requires that a CIP contain procedures that describe the documents the broker/dealer will use for verification.<sup>25</sup> Each broker/dealer must conduct its own risk-based analysis of the types of documents that it believes will enable it to verify the true identities of customers. Examples of documents that firms may use for verification include:

- ▶ For an individual, an unexpired government-issued identification evidencing nationality or residence and bearing a photograph or similar safeguard, such as a driver's license or passport; and
- ▶ For a person other than an individual (such as a corporation, partnership, or trust), documents showing the existence of the entity, such as certified articles of incorporation, a government-issued business license, a partnership agreement, or a trust instrument.<sup>26</sup>

These documents are merely examples of reliable documents. A firm may use other documents for verification provided that the documents allow a firm to establish a reasonable belief that it knows the true identity of the customer.

The Adopting Release encourages firms to obtain more than one type of documentary verification to ensure that they have a reasonable belief that they know their customers' true identities. This will increase the likelihood of finding inconsistencies if a person is attempting to provide false information. Also firms should use a variety of methods to verify the identity of a customer, especially when the broker/dealer does not have

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the ability to examine the original documents.<sup>27</sup>

The final rule generally does not require a firm to ensure the validity of documents.<sup>28</sup> The Adopting Release explains that, once a firm obtains and verifies the identity of a customer through a document, such as a driver's license or passport, a firm is not required to take steps to determine whether the document has been validly issued. A firm may rely on a government-issued identification as verification of a customer's identity. If, however, a firm notes that the document shows some obvious form of fraud, the firm must consider that factor in determining whether it can form a reasonable belief that it knows the customer's true identity.<sup>29</sup>

#### ***Verification through non-documentary methods***

The final rule requires a CIP to contain procedures that describe the non-documentary methods the broker/dealer will use for verification.<sup>30</sup> Examples of non-documentary methods of verification include:

- ◆ Contacting a customer;
- ◆ Independently verifying the customer's identity through the comparison of information provided by the customer with information obtained from a consumer reporting agency, public database,<sup>31</sup> or other source;
- ◆ Checking references with other financial institutions; or
- ◆ Obtaining a financial statement.<sup>32</sup>

Treasury and the SEC recommend that firms analyze whether there is a logical consistency between the identifying

information provided, such as the customer's name, street address, zip code, telephone number (if provided), date of birth, and Social Security number (e.g., zip code and city/state are consistent).

The final rule requires that a broker/dealer's CIP address the following circumstances where non-documentary procedures must be used:

- ◆ An individual is unable to present an unexpired government-issued identification document that bears a photograph or similar safeguard;
- ◆ The broker/dealer is not familiar with the documents presented;
- ◆ The account is opened without obtaining documents;
- ◆ The customer opens the account without appearing in person at the broker/dealer; and
- ◆ Where the broker/dealer is otherwise presented with circumstances that increase the risk that the broker/dealer will be unable to verify the true identity of a customer through documents.<sup>33</sup>

Due to the prevalence of identity theft and because identification documents may be obtained illegally and be fraudulent, firms are encouraged to use non-documentary methods even when a customer has provided identification documents.<sup>34</sup>

#### ***Additional Verification for Certain Customers***

Treasury and the SEC added a new provision to the final rule regarding additional verification for certain customers. The Adopting Release explains that, while firms may be able to verify the majority of customers adequately

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through documentary and non-documentary methods, there may be instances where those methods are inadequate.<sup>35</sup> The risk that a firm may not know the customer's true identity may be heightened for certain types of accounts, such as an account opened in the name of a corporation, partnership, or trust that is created or conducts substantial business in a jurisdiction that has been designated by the U.S. as a primary money laundering concern or has been designated as non-cooperative by an international body.<sup>36</sup> Treasury and the SEC emphasize that a firm must take further steps to identify customers that pose a heightened risk of not being properly identified. A firm's CIP must prescribe additional measures that may be used to obtain information about the identity of the individuals associated with the customer when standard documentary methods prove to be insufficient.<sup>37</sup>

Therefore, the final rule requires that a CIP address situations where, based on the broker/dealer's risk assessment of a new account opened by a customer that is not an individual, the broker/dealer will obtain information about individuals with authority or control over such account. This verification method applies only when the broker/dealer cannot verify the customer's true identity using documentary and non-documentary verification methods.<sup>38</sup>

### **Lack of Verification**

A CIP must include procedures for responding to circumstances in which a broker/dealer cannot form a reasonable belief that it knows the true identity of a customer.<sup>39</sup> These procedures should describe:

- ◆ When the broker/dealer should not open an account;
- ◆ The terms under which a customer may conduct transactions while the broker/dealer attempts to verify the customer's identity;
- ◆ When the broker/dealer should close an account after attempts to verify a customer's identity fail; and
- ◆ When the broker/dealer should file a Suspicious Activity Report (Form SAR-SF) in accordance with applicable law and regulation.<sup>40</sup>

### **Recordkeeping**

#### ***Required records***

A CIP must include procedures for making and maintaining a record of all information obtained to verify a customer's identity.<sup>41</sup> At a minimum, the record must include all identifying information about a customer obtained to verify a customer's identity.

With regard to verification, a firm's records must contain a description of any document that was relied on to verify the customer's identity, noting the type of document, any identification number contained in the document, the place of issuance, and, if any, the date of issuance and expiration date. This differs from the proposed rule, which required that firms keep copies of verification documents.

With respect to non-documentary verification, the final rule requires that records contain a description of the methods and the results of any measures undertaken to verify the identity of a customer.

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Finally, the final rule requires, with respect to any method of verification chosen, a description of the resolution of each substantive discrepancy discovered when verifying the identifying information obtained.<sup>42</sup>

#### ***Retention of records***

A broker/dealer must retain records of all of the identification information obtained from the customer for five years after the account is closed.<sup>43</sup> In addition, records made about information that verifies a customer's identity only have to be retained for five years after the record is made. In all other respects, the records must be maintained pursuant to the provisions of SEC Rule 17a-4.<sup>44</sup>

#### ***Comparison with Government Lists***

A CIP must include procedures for determining whether a customer appears on any list of known or suspected terrorists or terrorist organizations issued by any Federal government agency and designated as such by Treasury in consultation with the Federal functional regulators.<sup>45</sup> The procedures must require that the broker/dealer make such a determination within a reasonable period of time after the account is opened, or earlier if required by another Federal law or regulation or Federal directive issued in connection with the applicable list. The procedures also must require that the broker/dealer follow all Federal directives issued in connection with such lists.<sup>46</sup>

The Adopting Release notes that Treasury and the Federal functional regulators have not yet designated any government lists. The Adopting Release also notes that firms do not have an affirmative duty to seek out all lists of known or

suspected terrorists or terrorist organizations compiled by the federal government. Instead, firms will receive notification from the federal government regarding the lists that they must consult for purposes of this provision.

The Adopting Release also cautions that this does not mean that firms do not have obligations under other laws to screen their customer against government lists. It mentions, as an example, compliance with the OFAC rules prohibiting transactions with certain foreign countries and nationals. Firms must check the OFAC List to ensure that potential customers and existing customers, on an ongoing basis, are not prohibited persons or entities and are not from embargoed countries or regions before transacting any business with them.<sup>47</sup>

#### ***Customer Notice***

A CIP must include procedures "for providing customers with adequate notice that the broker/dealer is requesting information to verify their identities."<sup>48</sup> Notice must occur before the account is opened. Notice is adequate if the broker/dealer generally describes the identification requirements of the final rule and provides such notice in a manner reasonably designed to ensure that a customer is able to view the notice, or otherwise given notice, before opening an account.<sup>49</sup> For example, depending upon the manner in which the account is opened, a broker/dealer may post a notice in the lobby or on its Web site, include the notice on its account applications, or use any other form of oral or written notice.

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### **Sample Notice**

The final rule provides the following sample language for notice to be provided to a firm's customers, if appropriate:<sup>50</sup>

#### **Important Information About Procedures for Opening a New Account**

To help the government fight the funding of terrorism and money laundering activities, Federal law requires all financial institutions to obtain, verify, and record information that identifies each person who opens an account.

What this means for you: When you open an account, we will ask for your name, address, date of birth and other information that will allow us to identify you. We may also ask to see your driver's license or other identifying documents.

### **Reliance on Another Financial Institution**

The final rule acknowledges that there may be circumstances in which a firm may be able to rely on the performance by another financial institution of some or all of the elements of a firm's CIP.<sup>51</sup> Therefore, the final rule provides that a CIP *may* include procedures specifying when the broker/dealer will rely on the performance by another financial institution (including an affiliate) of any procedures of the broker/dealer's CIP, with respect to any customer of the broker/dealer that is opening an account or has established an account or similar business relationship with the other financial institution to provide or engage in services, dealings, or other financial transactions.

In order for a broker/dealer to rely on another financial institution, the following requirements must be met:

- ◆ Reliance must be reasonable under the circumstances;
- ◆ The other financial institution must be subject to a rule implementing the anti-money laundering compliance program requirements of the PATRIOT Act and be regulated by a Federal functional regulator; and
- ◆ The other financial institution must enter into a contract requiring it to certify annually to the broker/dealer that it has implemented its anti-money laundering program, and that it will perform (or its agent will perform) specified requirements of the broker/dealer's CIP.

The Adopting Release notes that the contract and certification will provide a standard means for a firm to demonstrate the extent to which it is relying on another financial institution to perform its CIP, and that the other institution has agreed to perform those functions.<sup>52</sup> If it is not clear from these documents, a broker/dealer must be able to otherwise demonstrate when it is relying on another financial institution to perform its CIP with respect to a particular customer. A broker/dealer will not be held responsible for the failure of the other financial institution to fulfill adequately the broker/dealer's CIP responsibilities, provided that the broker/dealer can establish that its reliance was reasonable and that it has obtained the requisite contracts and certifications.<sup>53</sup> Treasury and the SEC emphasize that the broker/dealer and the other financial institution upon which it relies must satisfy *all of the conditions* set forth in this final rule. If they do not, then the broker/dealer remains solely responsible for applying its own CIP to each customer in accordance with the rule.<sup>54</sup>

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## Endnotes

- 1 68 Fed. Reg. 25,113 (May 9, 2003) (“Adopting Release”).
- 2 31 C.F.R. § 103.122(a)(1).
- 3 Broker/dealers are advised to consider situations when it may be appropriate to verify the identity of customers associated with transferred accounts in developing and implementing the required anti-money laundering compliance program. 68 Fed. Reg. 25,113, 25,115.
- 4 The Adopting Release discusses why these accounts are excluded from the definition of “account.” Such accounts are less susceptible to be used for the financing of terrorism and money laundering because, among other things, they are funded through payroll deductions in connection with employment plans that must comply with federal regulations. These regulations impose, among other requirements, low contribution limits and strict distribution requirements. 68 Fed. Reg. 25,113, 25,115.
- 5 68 Fed. Reg. 25,113, 25,115.
- 6 However, the introducing firm and the clearing firm would need to meet the requirements for reliance on another financial institution (as discussed *supra* on page 355) such as entering into a contract and providing certifications to the extent that they intend to rely on each other to undertake CIP requirements with respect to customers that open accounts after the transfer. 68 Fed. Reg. 25,113, 25,115, fn. 20.
- 7 31 C.F.R. § 103.122(a)(2).
- 8 31 C.F.R. § 103.122(a)(4).
- 9 68 Fed. Reg. 25,113, 25,116. However, a broker/dealer, based on its risk-assessment of a new account, may need to take additional steps to verify the identity of a customer that is not an individual, such as obtaining information about persons with control over the account. In addition, the due diligence procedures required under other provisions of the BSA or securities laws may require broker/dealers to look through to owners of certain types of accounts. *Id.* at 25,115, fn. 30.
- 10 The final rule does not affect any requirements under SEC Rule 17a-3(a)(9) to make records with respect to the beneficial owners of certain accounts. 68 Fed. Reg. 25,113, 25,116, fn. 31.
- 11 68 Fed. Reg. 25,113, 25,116. See discussion *supra* at page 353.
- 12 31 C.F.R. § 103.122(a)(5).
- 13 31 C.F.R. § 103.122(a)(6).
- 14 31 C.F.R. § 103.122(a)(7).
- 15 31 C.F.R. § 103.122(a)(8).
- 16 31 C.F.R. § 103.122(a)(9).
- 17 31 C.F.R. § 103.122(b)(1). The Adopting Release notes that the provision permitting broker/dealers to rely on the performance of another financial institution for some or all of the elements of a firm’s CIP (as discussed *supra* on page 355) is not specified as a minimum CIP requirement because any such reliance is optional. 68 Fed. Reg. 25,113, 25,117, fn. 48.
- 18 31 C.F.R. § 103.122(b)(2)(i)(A). The Treasury and the SEC recognize that a foreign business or enterprise may not have an identification number. The Adopting Release states that when a firm is opening an account for a foreign business or enterprise that does not have an identification number, the broker/dealer must request alternative government-issued documentation certifying the existence of the business or enterprise. 68 Fed. Reg. 25,113, 25,118, fn. 65.
- 19 68 Fed. Reg. 25,113, 25,118, fn. 65. The Adopting Release emphasizes that the rule neither endorses nor prohibits a broker/dealer from accepting information from particular types of identification documents issued by foreign governments. The broker/dealer must determine, based upon appropriate risk factors, including those discussed on page 351 (under “Identity Verification Procedures”), whether the information presented by a customer is reliable.
- 20 31 C.F.R. § 103.122(b)(2)(i)(B).
- 21 31 C.F.R. § 103.122(b)(2).

- 22 31 C.F.R. § 103.122(b)(2)(ii). The Adopting Release notes that it is possible, however, that a firm would violate other laws by permitting a customer to transact business prior to verifying the customer identity. See, e.g., 31 C.F.R. Part 500 (regulations of Treasury's Office of Foreign Asset Control (OFAC)). Firms are prohibited from doing business with those persons and organizations listed on the OFAC Web Site as well as with the listed embargoed countries and regions. 68 Fed. Reg. 25,113, 25,119, (fn. 79).
- 23 68 Fed. Reg. 25,113, 25,119.
- 24 68 Fed. Reg. 25,113, 25,119.
- 25 31 C.F.R. § 103.122(b)(2)(ii)(A).
- 26 *Id.*
- 27 68 Fed. Reg. 25,113, 25,119.
- 28 *Id.*
- 29 *Id.* at 25,119-25,220.
- 30 31 C.F.R. § 103.122(b)(2)(ii)(B).
- 31 The Adopting Release does not list the specific types of databases that would be suitable for verification. It will depend on the circumstances and the firm's assessment of relevant risk factors. 68 Fed. Reg. 25,113, 25,120, fn. 95.
- 32 31 C.F.R. § 103.122(b)(2)(ii)(B)(1).
- 33 31 C.F.R. § 103.122(b)(2)(ii)(B)(2). The Adopting Release notes that there may be circumstances other than those described when a firm should use non-documentary verification procedures. 68 Fed. Reg. 25,113, 25,120, fn. 98.
- 34 68 Fed. Reg. 25,113, 25,120.
- 35 31 C.F.R. § 103.122(b)(2)(ii)(C).
- 36 See, e.g., the list of non-cooperative countries and territories published by the Financial Action Task Force on Money Laundering (FATF) at [http://www1.oecd.org/fatf/NCCT\\_en.htm](http://www1.oecd.org/fatf/NCCT_en.htm). The FATF is an intergovernmental body whose purpose is the development and promotion of policies to combat money laundering.
- 37 68 Fed. Reg. 25,113, 25,121.
- 38 *Id.*
- 39 31 C.F.R. § 103.122(b)(2)(iii).
- 40 68 Fed. Reg. 25,113, 25,121. For more information regarding the filing of Form SAR-SFs, see NASD Notice to Members 02-47, Treasury Issues Final Suspicious Activity Reporting Rule for Broker/Dealers; Effective Date: Transactions After December 30, 2002, <http://www.nasdr.com/pdf-text/0247ntm.pdf>.
- 41 31 C.F.R. § 103.122(b)(3).
- 42 The Adopting Release notes that the requirement was limited to substantive discrepancies to make clear that records would not have to be made in the case of minor discrepancies, such as those caused by typographical error. 68 Fed. Reg. 25,113, 25,121, fn. 111.
- 43 31 C.F.R. § 103.122(b)(3)(ii).
- 44 *Id.*
- 45 31 C.F.R. § 103.122(b)(4).
- 46 *Id.*
- 47 See, *infra* endnote 22; 68 Fed. Reg. 25,113, 25,122, fn. 120.
- 48 31 C.F.R. § 103.122(b)(5)(i).
- 49 31 C.F.R. § 103.122(b)(5)(ii).
- 50 31 C.F.R. § 103.122(b)(5)(iii).
- 51 31 C.F.R. § 103.122(b)(6).
- 52 68 Fed. Reg. 25,113, 25,123.
- 53 *Id.*
- 54 *Id.*

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# Special Notice to Members

JUNE 23, 2003

## SUGGESTED ROUTING

Legal & Compliance  
Senior Management

## KEY TOPICS

Cease and Desist Proceedings and Orders

## INFORMATIONAL

### Temporary Cease and Desist Orders

SEC Approves NASD Rule Change Giving NASD Authority to Issue and Enforce Temporary Cease and Desist Orders

#### Executive Summary

On May 23, 2003, the Securities and Exchange Commission (SEC) approved an NASD proposed rule change that gives NASD the authority to impose and enforce temporary cease and desist orders for alleged violations of specified securities laws and NASD rules.<sup>1</sup> The rule change also makes explicit NASD's authority to impose and enforce permanent cease and desist orders as a remedy in disciplinary cases. The SEC approved the rule change on a trial basis for a two-year period.<sup>2</sup> The new rule text is contained in Attachment A and is effective as of the date of this *Notice to Members (Notice)*.

#### Questions/Further Information

Questions regarding this *Notice* may be directed to James S. Wrona, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8270.

#### Background

In the past, NASD rules did not provide NASD staff with the means to respond rapidly to curtail certain types of serious misconduct by NASD members and associated persons. NASD's only means of addressing such situations was to prosecute a normal disciplinary action, a process that could take months to complete. In some instances, members or associated persons continued to engage in misconduct during the interim. In others, the members' or associated persons' financial condition significantly deteriorated.

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In either case, there was a significant risk that the investing public could be further harmed while the disciplinary action was adjudicated.

The rule change described in this *Notice* will allow NASD to address such situations quickly and effectively. It establishes procedures that enable NASD to issue temporary cease and desist orders and makes explicit NASD's ability to impose permanent cease and desist orders as a remedy in disciplinary cases. The rule change also gives NASD authority to initiate non-summary proceedings when respondents violate temporary or permanent cease and desist orders. The rule change will expire in two years from the date of this *Notice* unless it is renewed by NASD with SEC approval.

The rule change includes a number of procedural checks and safeguards to ensure that cease and desist proceedings are used prudently, sparingly, and fairly. NASD, for instance, may institute such proceedings only with the written authorization of the President of NASD Regulatory Policy and Oversight or the Executive Vice President for NASD Regulatory Policy and Programs. This provision ensures that such decisions are made at the highest NASD staff levels. In addition, NASD may initiate temporary cease and desist proceedings only for alleged violations of specified securities laws and NASD rules.<sup>3</sup>

After the President or Executive Vice President authorizes the initiation of a temporary cease and desist proceeding, NASD's prosecuting staff must file a notice with NASD's Office of Hearing Officers (OHO) and serve it on the respondent. The notice must set forth the rule or law that NASD staff alleges the respondent has violated (or is violating),

contain a declaration of facts that specifies the acts or omissions that constitute the alleged violation, and include a proposed order that contains the required elements of a temporary cease and desist order. In addition, if NASD staff has not already issued a complaint under NASD Rule 9211 against the respondent relating to the subject matter of the temporary cease and desist proceeding, NASD staff must serve the complaint with the notice initiating the temporary cease and desist proceeding.

Respondents also are entitled to a hearing before an OHO hearing panel prior to the issuance of a cease and desist order. Moreover, before a hearing panel can issue such an order, it must find, by a preponderance of the evidence, that the respondent committed the alleged violation and that the violative conduct, or its continuation, is likely to result in significant dissipation or conversion of assets or other significant harm to investors prior to the completion of the disciplinary proceeding under the Rule 9200 and 9300 Series.

If the hearing panel issues a temporary cease and desist order, the order will generally remain in effect until the conclusion of the underlying disciplinary proceeding. Furthermore, in any disciplinary proceeding for which a temporary cease and desist order has been issued, the hearing in the companion disciplinary matter will be held and the decision issued at the earliest possible time. If a respondent believes the companion disciplinary proceeding is not being conducted on an expedited basis, the respondent may petition the hearing panel to have the order modified, set aside, limited, or suspended. In addition, the respondent

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may seek to challenge a temporary cease and desist order by filing an application for review with the SEC pursuant to Section 19 of the Securities Exchange Act of 1934.<sup>4</sup>

The rule change also provides hearing panels the explicit authority to issue permanent cease and desist orders as a remedy in disciplinary proceedings. In addition, the rule change provides NASD with a mechanism to enforce both temporary and permanent cease and desist orders. NASD may suspend or cancel a respondent's membership or association if, after a non-summary proceeding under the Rule 9510 Series, an OHO hearing panel determines that the respondent violated the cease and desist order.<sup>5</sup>

In sum, this rule change provides NASD with a mechanism to take appropriate remedial action against a member or an associated person that has engaged (or is engaging) in violative conduct that could cause continuing harm to the investing public if not addressed expeditiously. At the same time, the rule change contains numerous procedural protections for respondents to ensure that the proceedings are fair.

## Endnotes

- 1 Exchange Act Release No. 47925 (May 23, 2003) (File No. SR-NASD-98-80), 68 Federal Register 33548 (June 4, 2003). The rule change authorizes NASD to initiate cease and desist proceedings for alleged violations of Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5 thereunder; Rules 15g-1 through 15g-9 under the Exchange Act; or NASD Rules 2110, 2120 or 2330. With regard to alleged violations of NASD rules, the rule change is further limited. For NASD Rule 2110, governing standards of commercial honor and just and equitable principles of trade, the alleged violations are limited to violations of Section 17(a) of the Securities Act of 1933 or circumstances involving unauthorized trading or misuse or conversion of customer assets. For NASD Rule 2330, governing members' use of customers' securities or funds, the alleged violations are limited to circumstances involving misuse or conversion of customer assets.
- 2 The temporary cease and desist order pilot will expire two years after the effective date indicated in this *Notice to Members* unless NASD seeks and obtains SEC approval to extend or permanently adopt the proposal.
- 3 See *supra* note 1.
- 4 A respondent's application to challenge an order, however, will not stay the effectiveness of the order, unless the SEC orders otherwise.
- 5 The President of NASD Regulatory Policy and Oversight or the Executive Vice President for NASD Regulatory Policy and Programs must provide written authorization before NASD prosecuting staff can institute a proceeding to suspend or cancel a respondent's association or membership for violating an order.

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## ATTACHMENT A

New language is underlined and deletions are in brackets.

### Text of Rule Change

### Sanctions

#### 8310. Sanctions for Violation of the Rules

##### (a) Imposition of Sanction

After compliance with the Rule 9000 Series, the Association may impose one or more of the following sanctions on a member or person associated with a member for each violation of the federal securities laws, rules or regulations thereunder, the rules of the Municipal Securities Rulemaking Board, or Rules of the Association, or may impose one or more of the following sanctions on a member or person associated with a member for any neglect or refusal to comply with an order, direction, or decision issued under the Rules of the Association:

(1) through (4) No Change.

(5) suspend or bar a member or person associated with a member from association with all members; [or]

(6) [impose any other fitting sanction.] impose a temporary or permanent cease and desist order against a member or a person associated with a member; or

(7) impose any other fitting sanction.

(b) No Change.

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## IM-8310-2. Release of Disciplinary Information

(a) through (c) No Change.

(d) (1) The Association shall release to the public information with respect to any disciplinary decision issued pursuant to the Rule 9000 Series imposing a suspension, cancellation or expulsion of a member; or suspension or revocation of the registration of a person associated with a member; or suspension or barring of a member or person associated with a member from association with all members; or imposition of monetary sanctions of \$10,000 or more upon a member or person associated with a member; or containing an allegation of a violation of a Designated Rule; and may also release such information with respect to any disciplinary decision or group of decisions that involve a significant policy or enforcement determination where the release of information is deemed by the President of NASD Regulation, Inc. to be in the public interest. The Association also may release to the public information with respect to any disciplinary decision issued pursuant to the Rule 8220 Series imposing a suspension or cancellation of the member or a suspension of the association of a person with a member, unless the National Adjudicatory Council determines otherwise. The National Adjudicatory Council may, in its discretion, determine to waive the requirement to release information with respect to a disciplinary decision under those extraordinary circumstances where the release of such information would violate fundamental notions of fairness or work an injustice. The Association also shall release to the public information with respect to any temporary cease and desist order issued pursuant to the Rule 9800 Series. The Association may release to the public information on any other final, litigated, disciplinary decision issued pursuant to the Rule 8220 Series or Rule 9000 Series, not specifically enumerated in this paragraph, regardless of sanctions imposed, so long as the names of the parties and other identifying information is redacted.

(A) through (B) No Change.

(2) No Change.

(e) through (l) No Change.

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## 9120. Definitions

(a) through (w) No Change.

### (x) "Party"

With respect to a particular proceeding, the term "Party" means:

in the Rule 9200 Series, [and] the Rule 9300 Series, and the Rule 9800 Series, the Department of Enforcement or the Department of Market Regulation or a Respondent;

(2) No Change.

(y) through (cc) No Change.

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## 9240. Pre-Hearing Conference and Submission

### 9241. Pre-Hearing Conference

(a) through (b) No Change.

#### (c) Subjects to be Discussed

At a pre-hearing conference, the Hearing Officer shall schedule an expedited proceeding as required by Rule 9290, and may consider and take action with respect to any or all of the following:

(1) through (10) No Change.

(d) through (f) No Change.

\* \* \* \* \*

## 9290. Expedited Disciplinary Proceedings

For any disciplinary proceeding, the subject matter of which also is subject to a temporary cease and desist proceeding initiated pursuant to Rule 9810 or a temporary cease and desist order, hearings shall be held and decisions shall be rendered at the earliest possible time. An expedited hearing schedule shall be determined at a pre-hearing conference held in accordance with Rule 9241.

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## **9310. Appeal to or Review by National Adjudicatory Council**

### **9311. Appeal by Any Party; Cross-Appeal**

(a) No Change.

#### **(b) Effect**

An appeal to the National Adjudicatory Council from a decision issued pursuant to Rule 9268 or Rule 9269 shall operate as a stay of that decision until the National Adjudicatory Council issues a decision pursuant to Rule 9349 or, in cases called for discretionary review by the NASD Board, until a decision is issued pursuant to Rule 9351. Any such appeal, however, will not stay a decision, or that part of a decision, that imposes a permanent cease and desist order.

(c) through (f) No Change.

### **9312. Review Proceeding Initiated By National Adjudicatory Council**

(a) No Change.

#### **(b) Effect**

Institution of review by a member of the National Adjudicatory Council on his or her own motion, a member of the Review Subcommittee on his or her own motion, or the General Counsel, on his or her own motion, shall operate as a stay of a final decision issued pursuant to Rule 9268 or Rule 9269 as to all Parties subject to the notice of review, until the National Adjudicatory Council issues a decision pursuant to Rule 9349, or, in cases called for discretionary review by the NASD Board, until a decision is issued pursuant to Rule 9351. Institution of any such review, however, will not stay a decision, or that part of a decision, that imposes a permanent cease and desist order.

(c) through (d) No Change.

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### **9360. Effectiveness of Sanctions**

Unless otherwise provided in the decision issued under Rule 9349 or Rule 9351, a sanction (other than a bar, [or] an expulsion, or a permanent cease and desist order) specified in a decision constituting final disciplinary action of the Association for purposes of SEC Rule 19d-1(c)(1) shall become effective on a date to be determined by Association staff. A bar, [or] an expulsion, or a permanent cease and desist order shall become effective upon service of the decision constituting final disciplinary action of the Association, unless otherwise specified therein. The Association shall serve the decision on a Respondent by courier, facsimile or other means reasonably likely to obtain prompt service when the sanction is a bar, [or] an expulsion, or a permanent cease and desist order.

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### **9511. Purpose and Computation of Time**

#### **(a) Purpose**

The Rule 9510 Series sets forth procedures for: (1) summary proceedings authorized by Section 15A(h)(3) of the Act; and (2) non-summary proceedings to impose (A) a suspension or cancellation for failure to comply with an arbitration award or a settlement agreement related to an arbitration or mediation pursuant to Article VI, Section 3 of the NASD By-Laws; (B) a suspension or cancellation of a member, or a limitation or prohibition on any member, associated person, or other person with respect to access to services offered by the Association or a member thereof, if the Association determines that such member or person does not meet the qualification requirements or other prerequisites for such access or such member or person cannot be permitted to continue to have such access with safety to investors, creditors, members, or the Association; [or] (C) an advertising pre-use filing requirement; or (D) a suspension or cancellation of the membership of a member or the registration of a person for failure to comply with a permanent cease and desist order entered pursuant to a decision issued under the Rule 9200 Series or Rule 9300 Series or a temporary cease and desist order entered pursuant to a decision issued under the Rule 9800 Series.

#### **(b) No Change.**

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### 9513. Initiation of Non-Summary Proceeding

#### (a) Notice

Association staff may initiate a proceeding authorized under Rule 9511(a)(2)(A) or (B), by issuing a written notice to the member, associated person, or other person. Association staff may initiate a proceeding authorized under Rule 9511(a)(2)(D), after receiving written authorization from the President of NASD Regulatory Policy and Oversight or the Executive Vice President for NASD Regulatory Policy and Programs, by issuing a written notice to the member or associated person. The notice shall specify the grounds for and effective date of the cancellation, suspension, bar, limitation, or prohibition and shall state that the member, associated person, or other person may file a written request for a hearing under Rule 9514. In addition, if the proceeding is authorized under Rule 9511(a)(2)(D), the notice shall specifically identify the provision of the permanent or temporary cease and desist order that is alleged to have been violated, and shall contain a statement of facts specifying the alleged violation. The notice shall be served by facsimile or overnight commercial courier.

#### (b) Effective Date

For any cancellation or suspension pursuant to Rule 9511(a)(2)(A), the effective date shall be at least 15 days after service of the notice on the member or associated person. For any action pursuant to Rule 9511(a)(2)(B) or (D), the effective date shall be at least seven days after service of the notice on the member or person, except that the effective date for a notice of a limitation or prohibition on access to services offered by the Association or a member thereof with respect to services to which the member, associated person, or other person does not have access shall be upon receipt of the notice.

#### (c) No Change.

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## **9800. TEMPORARY CEASE AND DESIST ORDERS**

(The entire Rule 9800 Series, and related amendments adopted by SR-NASD-98-80 to Rule 8310, IM-8310-2(d)(1), 9120(x), 9241(c), 9290, 9311(b), 9312(b), 9360, 9511(a), 9513(a) and 9513(b) shall expire on June 23, 2005, unless extended or permanently adopted by the Association pursuant to SEC approval at or before such date.)

### **9810. Initiation of Proceeding**

#### **(a) Department of Enforcement or Department of Market Regulation**

With the prior written authorization of the President of NASD Regulatory Policy and Oversight or the Executive Vice President for NASD Regulatory Policy and Programs, the Department of Enforcement or the Department of Market Regulation may initiate a temporary cease and desist proceeding with respect to alleged violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 thereunder; SEC Rules 15g-1 through 15g-9; NASD Rule 2110 (if the alleged violation is unauthorized trading, or misuse or conversion of customer assets, or based on violations of Section 17(a) of the Securities Act of 1933); NASD Rule 2120; or NASD Rule 2330 (if the alleged violation is misuse or conversion of customer assets). The Department of Enforcement or the Department of Market Regulation shall initiate the proceeding by serving a notice on a member or associated person (hereinafter "Respondent") and filing a copy thereof with the Office of Hearing Officers. The Department of Enforcement or the Department of Market Regulation shall serve the notice by personal service, overnight commercial courier, or facsimile. If service is made by facsimile, the Department of Enforcement or the Department of Market Regulation shall send an additional copy of the notice by overnight commercial courier. The notice shall be effective upon service.

#### **(b) Contents of Notice**

The notice shall set forth the rule or statutory provision that the Respondent is alleged to have violated and that the Department of Enforcement or the Department of Market Regulation is seeking to have the Respondent ordered to cease violating. The notice also shall state whether the Department of Enforcement or the Department of Market Regulation is requesting the Respondent to be required to take action or to refrain from taking action. The notice shall be accompanied by:

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(1) a declaration of facts, signed by a person with knowledge of the facts contained therein, that specifies the acts or omissions that constitute the alleged violation; and

(2) a proposed order that contains the required elements of a temporary cease and desist order (except the date and hour of the order's issuance), which are set forth in Rule 9840(b).

**(c) Filing of Underlying Complaint**

If the Department of Enforcement or the Department of Market Regulation has not issued a complaint under Rule 9211 against the Respondent relating to the subject matter of the temporary cease and desist proceeding and alleging violations of the rule or statutory provision specified in the notice described in paragraph (b), the Department of Enforcement or the Department of Market Regulation shall serve and file such a complaint with the notice initiating the temporary cease and desist proceeding.

**9820. Appointment of Hearing Officer and Hearing Panel**

(a) As soon as practicable after the Department of Enforcement or the Department of Market Regulation files a copy of the notice initiating a temporary cease and desist proceeding with the Office of Hearing Officers, the Chief Hearing Officer shall assign a Hearing Officer to preside over the temporary cease and desist proceeding. The Chief Hearing Officer shall appoint two Panelists to serve on a Hearing Panel with the Hearing Officer. The Panelists shall be current or former Governors, Directors, or National Adjudicatory Council members, and at least one Panelist shall be an associated person.

(b) If at any time a Hearing Officer or Hearing Panelist determines that he or she has a conflict of interest or bias or circumstances otherwise exist where his or her fairness might reasonably be questioned, or if a Party files a motion to disqualify a Hearing Officer or Hearing Panelist, the recusal and disqualification proceeding shall be conducted in accordance with Rules 9233 and 9234, except that:

(1) a motion seeking disqualification of a Hearing Officer or Hearing Panelist must be filed no later than 5 days after the later of the events described in paragraph (b) of Rules 9233 and 9234; and

(2) the Chief Hearing Officer shall appoint a replacement Panelist using the criteria set forth in paragraph (a) of this Rule.

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## **9830. Hearing**

### **(a) When Held**

The hearing shall be held not later than 15 days after service of the notice and filing initiating the temporary cease and desist proceeding, unless otherwise extended by the Hearing Officer with the consent of the Parties for good cause shown. If a Hearing Officer or Hearing Panelist is recused or disqualified, the hearing shall be held not later than five days after a replacement Hearing Officer or Hearing Panelist is appointed.

### **(b) Service of Notice of Hearing**

The Office of Hearing Officers shall serve a notice of date, time, and place of the hearing on the Department of Enforcement or the Department of Market Regulation and the Respondent not later than seven days before the hearing, unless otherwise ordered by the Hearing Officer. Service shall be made by personal service, overnight commercial courier, or facsimile. If service is made by facsimile, the Office of Hearing Officers shall send an additional copy of the notice by overnight commercial courier. The notice shall be effective upon service.

### **(c) Authority of Hearing Officer**

The Hearing Officer shall have authority to do all things necessary and appropriate to discharge his or her duties as set forth under Rule 9235.

### **(d) Witnesses**

A person who is subject to the jurisdiction of the Association shall testify under oath or affirmation. The oath or affirmation shall be administered by a court reporter or a notary public.

### **(e) Additional Information**

At any time during its consideration, the Hearing Panel may direct a Party to submit additional information. Any additional information submitted shall be provided to all Parties at least one day before the Hearing Panel renders its decision.

### **(f) Transcript**

The hearing shall be recorded by a court reporter and a written transcript thereof shall be prepared. A transcript of the hearing shall be available to the Parties for purchase from the court reporter at prescribed rates. A witness may purchase a copy of the transcript of his or her own testimony from the court reporter at prescribed rates. Proposed corrections to the

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transcript may be submitted by affidavit to the Hearing Panel within a reasonable time determined by the Hearing Panel. Upon notice to all the Parties to the proceeding, the Hearing Panel may order corrections to the transcript as requested or sua sponte.

**(g) Record and Evidence Not Admitted**

The record shall consist of the notice initiating the proceeding, the declaration, and the proposed order described in Rule 9810(b); the transcript of the hearing; all evidence considered by the Hearing Panel; and any other document or item accepted into the record by the Hearing Officer or the Hearing Panel. The Office of Hearing Officers shall be the custodian of the record. Proffered evidence that is not accepted into the record by the Hearing Panel shall be retained by the custodian of the record until the date when the NASD's decision becomes final or, if applicable, upon the conclusion of any review by the Commission or the federal courts.

**(h) Failure to Appear at Hearing**

If a Respondent fails to appear at a hearing for which it has notice, the allegations in the notice and accompanying declaration may be deemed admitted, and the Hearing Panel may issue a temporary cease and desist order without further proceedings. If the Department of Enforcement or Department of Market Regulation fails to appear at a hearing for which it has notice, the Hearing Panel may order that the temporary cease and desist proceeding be dismissed.

**9840. Issuance of Temporary Cease and Desist Order by Hearing Panel**

**(a) Basis for Issuance**

The Hearing Panel shall issue a written decision stating whether a temporary cease and desist order shall be imposed. The Hearing Panel shall issue the decision not later than ten days after receipt of the hearing transcript, unless otherwise extended by the Hearing Officer with the consent of the Parties for good cause shown. A temporary cease and desist order shall be imposed if the Hearing Panel finds:

(1) by a preponderance of the evidence that the alleged violation specified in the notice has occurred; and

(2) that the violative conduct or continuation thereof is likely to result in significant dissipation or conversion of assets or other significant harm to investors prior to the completion of the underlying disciplinary proceeding under the Rule 9200 and 9300 Series.

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**(b) Content, Scope, and Form of Order**

A temporary cease and desist order shall:

(1) be limited to ordering a Respondent to cease and desist from violating a specific rule or statutory provision, and, where applicable, to ordering a Respondent to cease and desist from dissipating or converting assets or causing other harm to investors;

(2) set forth the alleged violation and the significant dissipation or conversion of assets or other significant harm to investors that is likely to result without the issuance of an order;

(3) describe in reasonable detail the act or acts the Respondent is to take or refrain from taking; and

(4) include the date and hour of its issuance.

**(c) Duration of Order**

A temporary cease and desist order shall remain effective and enforceable until the issuance of a decision under Rule 9268 or Rule 9269.

**(d) Service**

The Office of Hearing Officers shall serve the Hearing Panel's decision and any temporary cease and desist order by personal service, overnight commercial courier, or facsimile. If service is made by facsimile, the Office of Hearing Officers shall send an additional copy of the Hearing Panel's decision and any temporary cease and desist order by overnight commercial courier. The temporary cease and desist order shall be effective upon service.

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### **9850. Review by Hearing Panel**

At any time after the Office of Hearing Officers serves the Respondent with a temporary cease and desist order, a Party may apply to the Hearing Panel to have the order modified, set aside, limited, or suspended. The application shall set forth with specificity the facts that support the request. The Hearing Panel shall respond to the request in writing within ten days after receipt of the request, unless otherwise extended by the Hearing Officer with the consent of the Parties for good cause shown. The Hearing Panel's response shall be served on the Respondent via personal service, overnight commercial courier, or facsimile. If service is made by facsimile, the Office of Hearing Officers shall send an additional copy of the temporary cease and desist order by overnight commercial courier. The filing of an application under this Rule shall not stay the effectiveness of the temporary cease and desist order.

### **9860. Violation of Temporary Cease and Desist Orders**

A Respondent who violates a temporary cease and desist order imposed under this Rule Series may have its association or membership suspended or canceled under the Rule 9510 Series. The President of NASD Regulatory Policy and Oversight or the Executive Vice President for NASD Regulatory Policy and Programs must authorize the initiation of any such proceeding in writing.

### **9870. Application to Commission for Review**

Temporary cease and desist orders issued pursuant to this Rule Series constitute final and immediately effective disciplinary sanctions imposed by the Association. The right to have any action under this Rule Series reviewed by the Commission is governed by Section 19 of the Exchange Act. The filing of an application for review shall not stay the effectiveness of the temporary cease and desist order, unless the Commission otherwise orders.

# Notice to Members

JUNE 2003

## SUGGESTED ROUTING

Corporate Finance  
Legal and Compliance  
Operations  
Senior Management  
Technology  
Trading and Market Making  
Training

## KEY TOPICS

Debt Securities  
Operations  
Rule 6200 Series  
Transaction Reporting

## INFORMATIONAL

### Corporate Debt Securities

SEC Approves Amendments to TRACE Rule 6230 to Reduce the Reporting Period to 45 Minutes

#### Executive Summary

On June 18, 2003, the Securities and Exchange Commission (SEC or Commission) approved amendments to Rule 6230 of the Trade Reporting and Compliance Engine (TRACE) Rules (Rule 6200 Series).<sup>1</sup> The amendments to TRACE Rule 6230 reduce the time to report a transaction in a TRACE-eligible security from 75 minutes to 45 minutes. Rule 6230, as amended, is set forth in Attachment A.

The amendments to Rule 6230 will become effective on October 1, 2003.

#### Questions/Further Information

Questions concerning this *Notice* should be directed to [tracefeedback.com](http://tracefeedback.com); Elliot Levine, Chief Counsel, Market Operations, Regulatory Services and Operations, at (212) 858-4174; or Sharon K. Zackula, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8985.

#### Background and Discussion

On July 1, 2002, when TRACE became effective, members were required to report required transaction information in TRACE-eligible corporate debt securities within 75 minutes of the time of execution. At that time, NASD indicated that it planned to reduce the reporting period after members had obtained experience reporting. Reducing the reporting period was, and continues to

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be, an important regulatory goal that results in the market receiving market-based pricing information more quickly, which enhances the transparency of the debt market.

On May 2, 2003, NASD proposed to reduce the reporting period from 75 minutes to 45 minutes. Since 1999, NASD, the SEC, and industry participants have discussed reducing the reporting period after members obtained experience reporting corporate bond transactions to TRACE. Since July 1, 2002, when TRACE began, members have obtained that reporting experience. In addition, during the first year of TRACE, members have developed the technical and operational capabilities to report transactions within a much shorter period than the current 75-minute period. TRACE data shows that approximately 80% of all reported transactions (measured either by transaction count or par value) currently are being reported to TRACE within 45 minutes.

### 45 Minute Reporting Requirement

The SEC approved the 45 minute reporting requirement on June 18, 2003. Thus, generally, in Rule 6230(a) and (a)(1), as amended, a member must report a transaction in a TRACE-eligible security within 45 minutes of the time of execution. In addition, NASD reduced other 75 minute reporting periods to 45 minutes in paragraphs (1) through (4) of Rule 6230(a). Specifically, under Rule 6230(a)(1) as amended, if a member executes a transaction within 45 minutes of the time the TRACE system closes, a member is *permitted* to report the transaction the next business day that the TRACE system opens, but must do so within 45 minutes after the TRACE system

opens for the report to be timely.<sup>2</sup> Under Rule 6230(a)(2) as amended, a member is *required* to report a transaction that occurs after the TRACE system closes the next business day that the TRACE system opens, and must do so within 45 minutes after the TRACE system opens. Similarly, under paragraphs (a)(3) and (a)(4) as amended, a member is *required* to report on the next business day that the TRACE system opens, and within 45 minutes of the TRACE system open, any transaction in a TRACE-eligible security that occurs at or after 12:00 a.m. (midnight) through 7:59:59 a.m., Eastern Time, or during a weekend or a holiday

### Effective Date

The amendments to Rule 6230 will become effective on October 1, 2003. Based on current reporting practices, it appears that many members are already technically and operationally capable of reporting within 45 minutes. By October 1, 2003, NASD expects that the membership as a whole will be able to report within 45 minutes, and intends to guide members in making the transition.

### Endnotes

- 1 See Securities Exchange Act Release No. 48056 (June 18, 2003), 68 Fed. Reg. 37886 (June 25, 2003) (File No. SR-NASD-2003-78).
- 2 Generally, the TRACE System is open to receive reports Monday through Friday, from 8:00 a.m. through 6:29:59 p.m., Eastern Time.

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## **EXHIBIT A**

### **6200. TRADE REPORTING AND COMPLIANCE ENGINE (TRACE)**

#### **6230. Transaction Reporting**

##### **(a) When and How Transactions are Reported**

A member that is required to report transaction information pursuant to paragraph (b) below must report such transaction information within [one hour and fifteen]45 minutes of the time of execution, except as otherwise provided below, or the transaction report will be "late." The member must transmit the report to TRACE during the hours the TRACE system is open ("TRACE system hours"), which are 8:00 a.m. Eastern Time through 6:29:59 p.m. Eastern Time. Specific trade reporting obligations during a 24-hour cycle are set forth below.

##### **(1) Transactions Executed During TRACE System Hours**

Transactions in TRACE-eligible securities executed on a business day at or after 8:00 a.m. Eastern Time through 6:29:59 p.m. Eastern Time must be reported within 45[one hour and fifteen] minutes of the time of execution. If a transaction is executed on a business day less than 45[one hour and fifteen] minutes before 6:30 p.m. Eastern Time, a member may report the transaction the next business day within 45[one hour and fifteen] minutes after the TRACE system opens. If reporting the next business day, the member must indicate "as/of" and provide the actual transaction date.

##### **(2) Transactions Executed At or After 6:30 P.M. Through 11:59:59 P.M. Eastern Time**

Transactions in TRACE-eligible securities executed on a business day at or after 6:30 p.m. Eastern Time through 11:59:59 p.m. Eastern Time must be reported the

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next business day within 45[one hour and fifteen] minutes after the TRACE system opens. The member must indicate "as/of" and provide the actual transaction date.

**(3) Transactions Executed At or After 12:00 A.M. Through 7:59:59 A.M. Eastern Time**

Transactions in TRACE-eligible securities executed on a business day at or after 12:00 a.m. Eastern Time through 7:59:59 a.m. Eastern Time must be reported the same day within 45[one hour and fifteen] minutes after the TRACE system opens.

**(4) Transactions Executed on a Non-Business Day**

Transactions in TRACE-eligible securities executed on a Saturday, Sunday, or a federal or religious holiday on which the TRACE system is closed, at any time during that day (determined using Eastern Time), must be reported the next business day within 45[one hour and fifteen] minutes after the TRACE system opens. The transaction must be reported as follows: the date of execution must be the first business day (the same day the report must be made); the execution time must be "12:01:00 a.m. Eastern Time" (stated in military time as "00:01:00"); and the modifier, "special price," must be selected. In addition, the transaction must not be designated "as/of". When the reporting method chosen provides a "special price" memo field, the member must enter the actual date and time of the transaction in the field.

**(5) through (6) No Change**

**(b) through (f) No Change**

# Notice to Members

JULY 2003

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Principals  
Registration  
Registered Representatives  
Senior Management  
Training

## KEY TOPICS

Qualification Examinations  
General Securities Principal Sales  
Supervisor Module (Series 23)  
General Securities Principal (Series 24)  
General Securities Sales Supervisor  
(Series 9/10)

## INFORMATIONAL

### Registration Rules

**New Series 23 Examination; Effective Date:  
July 7, 2003**

#### Executive Summary

On June 4, 2003, NASD filed with the Securities and Exchange Commission (SEC) for immediate effectiveness a proposed rule change to establish the General Securities Principal Sales Supervisor Module (Series 23) examination program.<sup>1</sup> The new Series 23 examination, in combination with the General Securities Sales Supervisor (Series 9/10) examination, will be an acceptable qualification alternative to the General Securities Principal (Series 24) examination for associated persons who are required to register and qualify as a General Securities Principal with NASD. The Series 23 examination covers material from the Series 24 examination not otherwise covered under the Series 9/10 examination. The implementation date of the new Series 23 examination is July 7, 2003.

#### Questions/Further Information

Questions concerning this *Notice* may be directed to Afshin Atabaki, Attorney, Office of General Counsel, NASD Regulatory Policy and Oversight, at (202) 728-8902, or one of the following persons in NASD's Testing and Continuing Education Department: Carole Hartzog at (240) 386-4678; Eva Cichy at (240) 386-4680; Elaine Warren at (240) 386-4679; or Karen Bescher at (240) 386-4677.

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## Background/Discussion

The SEC recently approved a proposed rule change to NYSE Rule 342 that recognized NASD's Series 24 examination as an acceptable qualification alternative to the Series 9/10 examination for a General Securities Sales Supervisor whose duties do not include the supervision of options or municipal securities sales activity.<sup>2</sup> In an effort to establish reciprocal qualification standards, NASD will permit General Securities Sales Supervisors to register and qualify as a General Securities Principal by passing the newly developed Series 23 qualification examination.

NASD developed the Series 23 examination program to allow persons associated with NASD members who are registered as a General Securities Sales Supervisor and who are seeking to register and qualify as a General Securities Principal an alternative to completing the Series 24.

The Series 23 examination is a limited qualification examination that covers those subject matters that are covered on the Series 24 examination, but not included on the Series 9/10 examination. A committee of industry representatives that oversees the Series 24 examination program, together with NASD staff, compared the subject matters covered on the Series 9/10 and Series 24 examinations to determine the topics that would be extracted from the Series 24 examination to create the Series 23 examination program. The Series 23 examination program tests a candidate's knowledge of securities industry rules and regulations pertaining to the supervision of

investment banking, securities markets, and trading as well as financial responsibility requirements. The committee, including NASD staff, developed the selection specifications, study outline, and question bank for the Series 23 examination.

## Prerequisite Examination

In order to take the Series 23, an individual must be registered as a General Securities Sales Supervisor, or have been registered in this capacity within the past two years.<sup>3</sup>

## The New Series 23 Examination

A study outline has been created to assist member firms in preparing candidates for the new Series 23 examination. The study outline may be used to structure or prepare training material, develop lecture notes and seminar programs, and serve as a training aide for the candidates themselves.

The Series 23 examination contains 100 questions, and candidates are allowed 2½ hours to complete the examination. A candidate must correctly answer 70 percent of the questions to receive a passing grade. The test is administered as a closed-book exam. The proctor will provide scratch paper and a basic electronic calculator. At the completion of the test, candidates will be provided with an informational breakdown of their performance on each of the sections, along with their overall score.

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The Series 23 outline and test are divided into five topical sections, which are listed below along with the number of questions designated to each section.

**Section 1:** Supervision of Investment Banking Activities (25)

**Section 2:** Supervision of Trading and Market Making Activities (29)

**Section 3:** Supervision of Brokerage Office Operations (16)

**Section 4:** Sales Supervision, General Supervision of Employees, Regulatory Framework of NASD (19)

**Section 5:** Compliance with Financial Responsibility Rules (11)

The questions used in the examination will be updated to reflect changes in the federal securities laws and NASD rules. Questions on new rules will be added to the examination within a reasonable period of their effective dates. Questions on rescinded rules will be promptly deleted from the examination. Candidates will only be asked questions pertaining to rules that are effective at the time they take their exams.

### Availability Of Study Outline

The study outline for the new Series 23 examination program will be available shortly from NASD's Qualifications Web Page at: [http://www.nasdr.com/5200\\_explan.htm](http://www.nasdr.com/5200_explan.htm).

### Endnotes

- 1 See Securities Exchange Act Release No. 48042 (June 17, 2003), 68 FR 37186 (June 23, 2003) (notice of filing and immediate effectiveness of File No. SR-NASD-2003-91).
- 2 See Securities Exchange Act Release No. 46631 (October 9, 2002), 67 FR 64187 (October 17, 2002) (order approving File No. SR-NYSE-2002-24).
- 3 As a prerequisite to the Series 23 examination, NASD also will recognize the Series 8, the historical equivalent to the Series 9/10, and the Series 12, a subset of the Series 9/10 omitting questions on options and municipal securities.

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# Notice to Members

JULY 2003

## SUGGESTED ROUTING

Advertising  
Internal Audit  
Investment Companies  
Legal & Compliance  
Registered Representatives  
Senior Management  
Variable Contracts

## KEY TOPICS

Advertising  
Communications with the Public  
NASD Rule 2210

## INFORMATIONAL

### Advertising Modernization

SEC Approves Amendments to NASD Rules Governing Member Communications with the Public

#### Executive Summary

On May 9, 2003, the Securities and Exchange Commission ("SEC" or "Commission") approved amendments to NASD Rule 2210 (Communications with the Public) and the Interpretive Materials that follow Rule 2210, the creation of new Rule 2211 (Institutional Sales Material and Correspondence), and the renumbering of current Rule 2211 (Telemarketing) as Rule 2212 (collectively, the "Amendments").<sup>1</sup> The Amendments modernize, simplify, and clarify the rules governing member communications with the public. The Amendments become effective on November 3, 2003. The amended Rule 2210 and accompanying Interpretive Materials are set forth in Attachment A.

#### Questions/Further Information

Questions concerning this *Notice* should be directed to the Advertising Regulation Department, Regulatory Policy and Oversight, at (240) 386-4500.

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## Background

The Amendments modernize and clarify the rules governing member communications with the public. Among the most notable changes, the Amendments exclude all communications to institutional investors from member pre-use approval and NASD filing requirements and from many of the content standards. Form letters and group e-mail to existing retail customers and fewer than 25 prospective retail customers also are eligible for these exclusions, provided that a member has appropriate policies and procedures to supervise and review such communications. Additionally, the Amendments exclude “independently prepared reprints” from the filing requirements and many of the content standards, and exclude certain press releases from the filing requirements. The Amendments also simplify the content standards applicable to those covered member communications.

## Reorganization of Rule 2210

The Amendments rewrite many of the current regulatory standards contained in Rule 2210, and relocate certain of its provisions to other areas of the rule. In this regard, the Amendments substantially shorten and simplify the standards applicable to communications with the public, which are currently contained in Rule 2210(d). The Amendments relocate certain of these standards to new Interpretive Material 2210-1, Guidelines to Ensure that Communications Are Not Misleading.<sup>2</sup> IM-2210-1 makes clear that members have the primary responsibility to ensure that their communications with the public are not misleading, and rewrites many standards in plain English.

New IM-2210-1 eliminates certain of the specific standards currently in Rule 2210, including those regarding non-existent or self-conferred degrees or designations, offers of free service, claims for research facilities, hedge clauses, recruiting advertising, and periodic investment plans. To the extent that these provisions prohibited statements that are misleading, unbalanced, or inaccurate regarding particular types of communications, they duplicate Rule 2210's more general prohibition on use of such statements.

The Amendments also create new Rule 2211—a separate rule for institutional sales material and correspondence that should facilitate a reader's ability to determine how the advertising rules apply to those communications. In order to further simplify this process, the Amendments provide cross-references between Rule 2210 and Rule 2211 in appropriate places. Existing Rule 2211, concerning telemarketing, is renumbered as Rule 2212.

## Definition of “Communications with the Public”

The Amendments broaden the definition of “communications with the public” to include not only advertisements, sales literature, and correspondence, but also public appearances, institutional sales material, and independently prepared reprints.

## Public Appearances

The inclusion of public appearances within the definition of communications with the public does not change current NASD policy. In this regard, existing Rule 2210(d)(1)(C) provides that members who engage in public appearances or

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speaking activities must follow the content standards of Rule 2210(d) and (f). Consequently, public appearances already are subject to strict content requirements. New Rule 2210(a)(5) clarifies the application of Rule 2210 to such appearances by defining “public appearance” as a type of communication with the public.

Public appearances include participation in a seminar, forum (including an interactive electronic forum), radio or television interview, or other public appearance or public speaking activity. By defining “public appearance” to include an interactive electronic forum, the Amendments also codify the NASD staff’s position that Internet chat rooms constitute public appearances rather than advertisements or sales literature for purposes of Rule 2210. The Amendments also provide members with more flexibility by subjecting public appearances only to some, but not all, of the content standards of Rule 2210.

### **Institutional Sales Material**

Rule 2210 currently does not distinguish between retail and institutional sales material. Moreover, the rule currently defines “sales literature” to include any “form letter,” which NASD has interpreted to mean written communications, including e-mail messages sent to at least two persons. Consequently, any communication sent to two or more institutional investors currently is deemed “sales literature,” must comply with the content standards of Rule 2210, be pre-approved by a registered principal, and may have to be filed with the Advertising Regulation Department of NASD (the “Department”) if it concerns certain types of products, such as registered investment companies.

The Amendments eliminate the pre-use approval and filing requirements applicable to communications that are distributed or made available only to institutional investors. Instead, institutional sales material will be subject to new supervision and review requirements that are modeled on those in Rule 3010, which currently apply to correspondence. Moreover, institutional sales material will continue to be subject to the record-keeping requirements and some, but not all, of the content standards in Rule 2210.<sup>3</sup>

The institutional sales material definition contains an important caveat: no member may treat a communication as having been distributed to an institutional investor if the member has reason to believe that the communication or any excerpt thereof will be forwarded or made available to any person other than an institutional investor. For example, if a member has reason to believe that such a communication would be forwarded or made available to 401(k) plan participants or other beneficiaries of institutional accounts, it will be treated as retail sales material. Plan participants and other beneficiaries of institutional accounts are entitled to the same protections under the advertising rules as other retail investors. Similarly, an advertisement in a publication designed for broker/dealers or other institutional investors may not be treated as institutional sales material if the member has reason to believe that the publication will be made available to any person other than an institutional investor.

New Rule 2211(a)(3) defines “institutional investor” as any:

- ▶ person described in Rule 3110(c)(4), regardless of whether that person has an account with an NASD member;<sup>4</sup>

- ▶ governmental entity or subdivision thereof;
- ▶ employee benefit plan that meets the requirements of Section 403(b) or Section 457 of the Internal Revenue Code and has at least 100 participants, but does not include any participants of such a plan;
- ▶ qualified plan, as defined in Section 3(a)(12)(C) of the Securities Exchange Act of 1934, that has at least 100 participants, but does not include any participant of such a plan;
- ▶ NASD member or registered associated person of such a member;<sup>5</sup> and
- ▶ person acting solely on behalf of any such institutional investor.

### **Form Letters and Group Electronic Mail**

The definition of “correspondence” has been amended to include form letters and group e-mails sent to existing retail customers and to fewer than 25 prospective retail customers within any 30 calendar-day period (“Group Correspondence”), as well as written and electronic communications prepared for delivery to a single retail customer. Rule 2211(a)(4) defines “existing retail customer” as any person, other than an institutional investor, for whom the member or a clearing broker or dealer on behalf of the member carries an account, or who has an account with any registered investment company for which a member serves as principal underwriter. Thus, a person who has opened an account with an investment company or with a transfer agent for such an investment company could qualify as an existing retail customer of the investment company’s principal underwriter.

Pursuant to new Rule 2211(b)(1)(A), principal approval is not required of Group Correspondence; however, such correspondence will be subject to the strict supervisory procedures in Rule 3010(d), which governs the approval and review of correspondence, and to those content standards that apply to correspondence. Form letters and group e-mails sent to 25 or more prospective retail customers within any 30 calendar-day period will continue to be subject to the pre-use approval, filing, and record-keeping requirements of Rule 2210, and to all of the content standards applicable to sales literature.<sup>6</sup>

NASD believes that Rule 3010(d) provides the most effective means of supervising form letters and group e-mails sent to existing and a limited number of prospective retail customers. Rule 3010(d) requires members to adopt written procedures for the review of correspondence by registered principals. Any member that does not pre-approve all correspondence must educate and train associated persons as to NASD rules governing communications with the public and the firm’s procedures, document this training, and monitor adherence to these procedures. Members must retain all correspondence of registered representatives related to the member’s investment banking or securities business.

*Notice to Members 98-11* provides guidance to members concerning Rule 3010(d). The *Notice* makes clear that, at a minimum, a member must develop procedures for the review of some of each registered representative’s correspondence with the public relating to the member’s investment banking or securities business, tailored to its structure and the nature and size of its business and customers.

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The *Notice* provides that members must:

- ▶ specify in writing the firm’s policies and procedures for reviewing different types of correspondence;
- ▶ identify what types of correspondence will be pre- or post-reviewed by a registered principal; and
- ▶ periodically re-evaluate the effectiveness of the firm’s procedures for reviewing public correspondence and consider any necessary revisions.

These procedures must be reasonably designed to ensure that a member’s correspondence complies with the content standards of the applicable advertising rules.

Members will be expected to review their procedures to ensure that they adequately address potential concerns with the distribution of Group Correspondence. More specifically, members should consider whether to adopt stricter procedures that require registered principal pre-use approval and filing with NASD of Group Correspondence that presents a higher risk to investors. This determination should be based upon such factors as the content, purpose, and targeted audience of the Group Correspondence.

Thus, for example, members may wish to consider adopting procedures requiring pre-use principal review and filing as appropriate with NASD of Group Correspondence that promotes a new investment product or strategy that is sent to existing retail customers. In addition, members should strongly consider requiring pre-use principal review of Group Correspondence sent by a registered representative that has been disciplined in the past for advertising or sales practice violations.

## **Independently Prepared Reprints**

The Amendments define a new type of communication with the public, an “independently prepared reprint,” and exclude them from the filing requirements and most of the content standards. Under Rule 2210(a)(6)(A), an independently prepared reprint consists of any article reprint that meets certain standards that are designed to ensure that the reprint was issued by an independent publisher and was not materially altered by the member. A member may alter the contents of an independently prepared reprint in a manner necessary to make it consistent with applicable regulatory standards or to correct factual errors.

An article reprint qualifies as an “independently prepared reprint” under Rule 2210(a)(6)(A) only if, among other things, its publisher is not an affiliate of the member using the reprint or any underwriter or issuer of the security mentioned in the reprint. For purposes of this provision, “affiliate” has the same meaning as that term is defined in NASD Rule 2720(b)(1)(A) and (B). The term “affiliate” as used in Rule 2210(a)(6)(B) also has this meaning.

Pursuant to Rule 2210(a)(6)(B), independently prepared reprints also include independent reports concerning investment companies that meet certain standards. Under current Rule 2210(c)(7)(G), these types of reports are already exempt from the Rule 2210 filing requirements for investment company sales material. This filing exemption is maintained by including these reports within the definition of independently prepared reprint.

Some, but not all, content standards apply to independently prepared reprints. For example, Rule 2210(d)(1)

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will impose various content standards on all communications with the public, including independently prepared reprints. Independently prepared reprints are subject to the pre-use approval and record-keeping requirements of Rule 2210.

Article reprints and research reports that do not meet the definition of “independently prepared reprint” constitute sales literature that must meet all of the requirements applicable to sales literature.

## Filing Requirements

### General Filing Requirements

The Amendments maintain many of current Rule 2210’s filing requirements for advertisements and sales literature. In this regard, advertisements and sales literature concerning registered investment companies that are not governed by Rule 2210(c)(3) or Rule 2210(c)(4) still must be filed with the Department within 10 business days of first use or publication. This 10-business-day filing requirement also continues to apply to advertisements and sales literature concerning public direct participation programs and advertisements concerning government securities.

Rule 2210(c)(3) continues to apply a 10-business day pre-filing requirement to sales literature containing bond fund volatility ratings. New Rule 2210(c)(4) maintains the 10-business day pre-filing requirement for registered investment company advertisements and sales literature that include or incorporate self-created rankings or comparisons,

advertisements concerning collateralized mortgage obligations, and advertisements concerning security futures.

### Television and Video Advertisements

New Rule 2210(c)(6) requires members that have filed a draft version or “storyboard” of a television or video advertisement pursuant to a filing requirement also to file the final filmed version within 10 business days of first use or broadcast. This provision codifies an existing Department policy regarding television and video sales material. The Department imposes a filing fee only when the draft version or storyboard is filed. No additional fee is assessed when the final filmed version is filed.

### Press Releases

Rule 2210(a)(2) defines “sales literature” to include press releases concerning a member’s product or service. New Rule 2210(c)(8)(G) excludes from the filing requirements press releases that are made available only to members of the media.

### Legends and Footnotes

New Rule 2210(d)(1)(C) provides that information may be placed in a legend or footnote only when such placement would not inhibit an investor’s understanding of the communication. Thus, for example, footnotes in especially small type in an advertisement might be deemed to inhibit an investor’s understanding of the advertisement. Similarly, an advertisement that presents bold claims that are supposedly “balanced” only with footnote disclosure

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might not comply with this content standard.

## Use and Disclosure of a Member's Name

New Rule 2210(d)(2)(C) simplifies the current provisions concerning disclosure of member names by deleting many of the current specific provisions governing the use of member names. In addition, Rules 2210(d)(2)(C) and 2211(d)(2) make clear that the requirement to disclose the member's name applies to advertisements, sales literature, correspondence, business cards, and letterhead. NASD does not intend to modify the substance of the current standards in Rule 2210(f) with regard to use and disclosure of member names, however. Accordingly, members' use of names that meet the current standards of Rule 2210(f) will also be deemed to be in compliance with new Rules 2210(d)(2)(C) and 2211(d)(2).

## Recommendations

The provisions governing member recommendations have been relocated from current Rule 2210(d)(2)(B) to new IM-2210-1(6). These provisions have been modified in several respects to make them consistent with NASD Rule 2711, which requires certain disclosures when securities are recommended in member research reports.

First, current Rule 2210(d)(2)(B)(i)(a) requires a member to disclose if the member "usually" makes a market in the securities being recommended. New IM-2210-1(6)(A)(i) will require a member to disclose if the member was making a market in the securities being recommended at the time the advertisement or sales literature was published.

Second, current Rule 2210(d)(2)(B)(i)(b) requires a member to disclose if the member or its officers and partners own options, security futures, rights, or warrants to purchase the recommended issuer's securities, unless the extent of such ownership is nominal. New IM-2210-1(6)(A)(ii) will require the member to disclose if the member or its officers or partners have a financial interest in any of the recommended issuer's securities, and the nature of the financial interest, unless the extent of the financial interest is nominal. A member that discloses in its research reports that it owns one percent or more of any class of common equity securities of a recommended issuer pursuant to Rule 2711(h)(1)(B) will be deemed to be in compliance with the requirement to disclose its financial interest in the recommended issuer pursuant to IM-2210-1(6)(A)(ii).

Finally, current Rule 2210(d)(2)(B)(i)(b) requires a member to disclose if the member had acted as manager or co-manager of a public offering of the recommended issuer's securities within the last three years. Under new IM-2210-1(6)(A)(iii), this look-back period will be shortened to the past 12 months.

## Ranking Guidelines

New IM-2210-3 (Use of Rankings in Investment Companies Advertisements and Sales Literature) modifies the current ranking guidelines in several respects. First, IM-2210-3(b) makes clear that no advertisement or sales literature may present a ranking, except those (1) created and published by a Ranking Entity, which the ranking guidelines define to include certain independent entities, or (2) created by an investment company or an investment company affiliate but based on the performance

measurements of a Ranking Entity.<sup>7</sup> Second, the ranking guidelines in IM-2210-3 apply only to advertisements and sales literature.

Third, IM-2210-3(g) permits the use of investment company family rankings, provided that when a particular investment company is being advertised, the individual rankings for that investment company also must be presented. Of course, as with all performance rankings, use of an investment company family ranking must comply with the other applicable requirements of Rule 2210.

### Limitations on Use of NASD's Name

New IM-2210-4 simplifies and shortens the requirements concerning the use of NASD's name. The Amendments also delete current Rule 2210(d)(2)(J) concerning references to regulatory organizations.

### Communications About Collateralized Mortgage Obligations

The Amendments rewrite existing IM-2210-1 (the CMO Guidelines), which governs communications about collateralized mortgage obligations and renumber it as IM-2210-8. The Amendments simplify, shorten, and reorganize the CMO Guidelines to provide a more straightforward and uniform list of disclosure requirements.

### Endnotes

- 1 SEC Release No. 34-47820 (May 9, 2003), 68 Fed. Reg. 27116 (May 19, 2003) (SR-NASD-00-12) ([http://www.nasdr.com/pdf-text/rf03\\_94\\_app.pdf](http://www.nasdr.com/pdf-text/rf03_94_app.pdf)). On June 11, 2003, NASD filed a technical amendment to Rule 2210 that reinserted certain current Rule 2210 language that was inadvertently omitted from the Amendments. See SEC Release No. 34-48079 (June 24, 2003), 68 Fed. Reg. 39171 (July 1, 2003) (SR-NASD-2003-94).
- 2 The current IM-2210-1 concerning collateralized mortgage obligations is re-designated as IM-2210-8.
- 3 The Amendments revise the content standards to specifically indicate which type of communication is subject to each standard. Therefore, standards that apply only to "advertisements" or "sales literature" will not apply to institutional sales material. For example, the ranking guidelines in IM-2210-3 will apply only to advertisements and sales literature and therefore will not apply to institutional sales material.
- 4 Rule 3110(c)(4) defines "institutional account" to mean the account of a bank, savings and loan, insurance company, registered investment company, or registered investment adviser. It also includes the account of any other entity or natural person with total assets of at least \$50 million. For purposes of Rule 2210 and Rule 2211, the term "institutional investor" includes trust companies organized under state law that come within the definition of "bank" in Article I(b) of the NASD By-Laws.
- 5 Currently all content standards of Rule 2210 apply to advertisements and sales literature sent only to members or their registered persons. By including this material within the definition of institutional sales material, and subjecting it only to those standards applicable to institutional sales material, the Amendments provide members with more flexibility to include various information in broker/dealer-only material.

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- 6 The Amendments will permit members to treat form letters or group e-mail sent to a *combination* of existing customers and fewer than 25 prospective retail customers within any 30 calendar-day period as correspondence. Of course, members may not “sanitize” an advertisement or item of sales literature by enclosing it with Group Correspondence. For example, an item that a member has distributed as sales literature will remain sales literature for purposes of Rule 2210 when the member encloses it in Group Correspondence.
  - 7 The application of this limitation to correspondence would appear in new Rule 2211(d)(3) rather than in IM-2210-3.

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## ATTACHMENT A

*As of November 3, 2003, current Rule 2210 and Interpretive Materials 2210-1, 2210-3, and 2210-4 are replaced with the following rule language. In addition, as of November 3, 2003, Interpretive Materials 2210-2 and 2210-7 are revised as shown below, and new Rule 2211 and Interpretive Material 2210-8 become effective.*

### 2210. Communications with the Public

(a) **Definitions** - For purposes of this Rule and any interpretation thereof, "communications with the public" consist of:

(1) "Advertisement." Any material, other than an independently prepared reprint and institutional sales material, that is published or used in any electronic or other public media, including any Web site, newspaper, magazine or other periodical, radio, television, telephone or tape recording, videotape display, signs or billboards, motion pictures, or telephone directories (other than routine listings).

(2) "Sales Literature." Any written or electronic communication, other than an advertisement, independently prepared reprint, institutional sales material and correspondence, that is generally distributed or made generally available to customers or the public, including circulars, research reports, market letters, performance reports or summaries, form letters, telemarketing scripts, seminar texts, reprints (that are not independently prepared reprints) or excerpts of any other advertisement, sales literature or published article, and press releases concerning a member's products or services.

(3) "Correspondence" as defined in Rule 2211(a)(1).

(4) "Institutional Sales Material" as defined in Rule 2211(a)(2).

(5) "Public Appearance." Participation in a seminar, forum (including an interactive electronic forum), radio or television interview, or other public appearance or public speaking activity.

(6) "Independently Prepared Reprint."

(A) Any reprint or excerpt of any article issued by a publisher, provided that:

(i) the publisher is not an affiliate of the member using the reprint or any underwriter or issuer of a security mentioned in the reprint or excerpt and that the member is promoting;

(ii) neither the member using the reprint or excerpt nor any underwriter or issuer of a security mentioned in the reprint or excerpt has commissioned the reprinted or excerpted article; and

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(iii) the member using the reprint or excerpt has not materially altered its contents except as necessary to make the reprint or excerpt consistent with applicable regulatory standards or to correct factual errors;

(B) Any report concerning an investment company registered under the Investment Company Act of 1940, provided that:

(i) the report is prepared by an entity that is independent of the investment company, its affiliates, and the member using the report (the "research firm");

(ii) the report's contents have not been materially altered by the member using the report except as necessary to make the report consistent with applicable regulatory standards or to correct factual errors;

(iii) the research firm prepares and distributes reports based on similar research with respect to a substantial number of investment companies;

(iv) the research firm updates and distributes reports based on its research of the investment company with reasonable regularity in the normal course of the research firm's business;

(v) neither the investment company, its affiliates nor the member using the research report has commissioned the research used by the research firm in preparing the report; and

(vi) if a customized report was prepared at the request of the investment company, its affiliate or a member, then the report includes only information that the research firm has already compiled and published in another report, and does not omit information in that report necessary to make the customized report fair and balanced.

**(b) Approval and Recordkeeping**

**(1) Registered Principal Approval for Advertisements, Sales Literature and Independently Prepared Reprints**

A registered principal of the member must approve by signature or initial and date each advertisement, item of sales literature and independently prepared reprint before the earlier of its use or filing with NASD's Advertising Regulation Department ("Department"). With respect to debt and equity securities that are the subject of research reports as that term is defined in Rule 472 of the New York Stock Exchange, this requirement may be met by the signature or initial of a supervisory analyst approved pursuant to Rule 344 of the New York Stock Exchange. A registered

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principal qualified to supervise security futures activities must approve by signature or initial and date each advertisement or item of sales literature concerning security futures.

**(2) Record-keeping**

(A) Members must maintain all advertisements, sales literature, and independently prepared reprints in a separate file for a period of three years from the date of last use. The file must include the name of the registered principal who approved each advertisement, item of sales literature, and independently prepared reprint and the date that approval was given.

(B) Members must maintain in a file information concerning the source of any statistical table, chart, graph or other illustration used by the member in communications with the public.

**(c) Filing Requirements and Review Procedures**

**(1) Date of First Use and Approval Information**

The member must provide with each filing under this paragraph the actual or anticipated date of first use, the name and title of the registered principal who approved the advertisement or sales literature, and the date that the approval was given.

**(2) Requirement to File Certain Material**

Within 10 business days of first use or publication, a member must file the following advertisements and sales literature with the Department:

(A) Advertisements and sales literature concerning registered investment companies (including mutual funds, variable contracts, continuously offered closed-end funds, and unit investment trusts) not included within the requirements of paragraph (c)(3). The filing of any advertisement or sales literature that includes or incorporates a performance ranking or performance comparison of the investment company with other investment companies must include a copy of the ranking or comparison used in the advertisement or sales literature.

(B) Advertisements and sales literature concerning public direct participation programs (as defined in Rule 2810).

(C) Advertisements concerning government securities (as defined in Section 3(a)(42) of the Act).

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### **(3) Sales Literature Containing Bond Fund Volatility Ratings**

Sales literature concerning bond mutual funds that include or incorporate bond mutual fund volatility ratings, as defined in Rule IM-2210-5, shall be filed with the Department for review at least 10 business days prior to use (or such shorter period as the Department may allow in particular circumstances) for approval and, if changed by NASD, shall be withheld from publication or circulation until any changes specified by NASD have been made or, if expressly disapproved, until the sales literature has been refiled for, and has received, NASD approval. Members are not required to file advertising and sales literature which have previously been filed and which are used without change. The member must provide with each filing the actual or anticipated date of first use. Any member filing sales literature pursuant to this paragraph shall provide any supplemental information requested by the Department pertaining to the rating that is possessed by the member.

### **(4) Requirement to File Certain Material Prior to Use**

At least 10 business days prior to first use or publication (or such shorter period as the Department may allow), a member must file the following communications with the Department and withhold them from publication or circulation until any changes specified by the Department have been made:

(A) Advertisements and sales literature concerning registered investment companies (including mutual funds, variable contracts, continuously offered closed-end funds and unit investment trusts) that include or incorporate performance rankings or performance comparisons of the investment company with other investment companies when the ranking or comparison category is not generally published or is the creation, either directly or indirectly, of the investment company, its underwriter or an affiliate. Such filings must include a copy of the data on which the ranking or comparison is based.

(B) Advertisements concerning collateralized mortgage obligations.

(C) Advertisements concerning security futures.

### **(5) Requirement for Certain Members to File Material Prior to Use**

(A) Each member that has not previously filed advertisements with the Department (or with a registered securities exchange having standards comparable to those contained in this Rule) must file its initial advertisement with the Department at least 10 business days prior to use and shall continue to file its advertisements at least 10 business days prior to use for a period of one year.

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(B) Notwithstanding the foregoing provisions, the Department, upon review of a member's advertising and/or sales literature, and after determining that the member has departed from the standards of this Rule, may require that such member file all advertising and/or sales literature, or the portion of such member's material that is related to any specific types or classes of securities or services, with the Department, at least 10 business days prior to use. The Department will notify the member in writing of the types of material to be filed and the length of time such requirement is to be in effect. Any filing requirement imposed under this paragraph will take effect 30 calendar days after the member receives the written notice, during which time the member may appeal pursuant to the hearing and appeal procedures of the Code of Procedure contained in the Rule 9510 Series.

#### **(6) Filing of Television or Video Advertisements**

If a member has filed a draft version or "story board" of a television or video advertisement pursuant to a filing requirement, then the member also must file the final filmed version within 10 business days of first use or broadcast.

#### **(7) Spot-Check Procedures**

In addition to the foregoing requirements, each member's written and electronic communications with the public may be subject to a spot-check procedure. Upon written request from the Department, each member must submit the material requested in a spot-check procedure within the time frame specified by the Department.

#### **(8) Exclusions from Filing Requirements**

The following types of material are excluded from the filing requirements and (except for the material in paragraphs (G) through (J)) the foregoing spot-check procedures:

(A) Advertisements and sales literature that previously have been filed and that are to be used without material change.

(B) Advertisements and sales literature solely related to recruitment or changes in a member's name, personnel, electronic or postal address, ownership, offices, business structure, officers or partners, telephone or teletype numbers, or concerning a merger with, or acquisition by, another member.

(C) Advertisements and sales literature that do no more than identify the Nasdaq or a national securities exchange symbol of the member or identify a security for which the member is a Nasdaq registered market maker.

(D) Advertisements and sales literature that do no more than identify the member or offer a specific security at a stated price.

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(E) Prospectuses, preliminary prospectuses, fund profiles, offering circulars and similar documents that have been filed with the Securities and Exchange Commission (the "SEC") or any state, or that is exempt from such registration, except that an investment company prospectus published pursuant to SEC Rule 482 under the Securities Act of 1933 will not be considered a prospectus for purposes of this exclusion.

(F) Advertisements prepared in accordance with Section 2(10)(b) of the Securities Act of 1933, as amended, or any rule thereunder, such as SEC Rule 134, and announcements as a matter of record that a member has participated in a private placement, unless the advertisements are related to direct participation programs or securities issued by registered investment companies.

(G) Press releases that are made available only to members of the media.

(H) Independently prepared reprints.

(I) Correspondence.

(J) Institutional sales material.

Although the material described in paragraphs (c)(8)(G) through (J) is excluded from the foregoing filing requirements, investment company communications described in those paragraphs shall be deemed filed with NASD for purposes of Section 24(b) of the Investment Company Act of 1940 and Rule 24b-3 thereunder.

(9) Material that refers to investment company securities, direct participation programs, or exempted securities (as defined in Section 3(a)(12) of the Act) solely as part of a listing of products or services offered by the member, is excluded from the requirements of paragraphs (c)(2) and (c)(4).

(10) Pursuant to the Rule 9600 Series, NASD may exempt a member or person associated with a member from the pre-filing requirements of this paragraph (c) for good cause shown.

**(d) Content Standards**

**(1) Standards Applicable to All Communications with the Public**

(A) All member communications with the public shall be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service. No member may omit any material fact or qualification if the omission, in the light of the context of the material presented, would cause the communications to be misleading.

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(B) No member may make any false, exaggerated, unwarranted or misleading statement or claim in any communication with the public. No member may publish, circulate or distribute any public communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.

(C) Information may be placed in a legend or footnote only in the event that such placement would not inhibit an investor's understanding of the communication.

(D) Communications with the public may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast. A hypothetical illustration of mathematical principles is permitted, provided that it does not predict or project the performance of an investment or investment strategy.

(E) If any testimonial in a communication with the public concerns a technical aspect of investing, the person making the testimonial must have the knowledge and experience to form a valid opinion.

## **(2) Standards Applicable to Advertisements and Sales Literature**

(A) Advertisements or sales literature providing any testimonial concerning the investment advice or investment performance of a member or its products must prominently disclose the following:

(i) The fact that the testimonial may not be representative of the experience of other clients.

(ii) The fact that the testimonial is no guarantee of future performance or success.

(iii) If more than a nominal sum is paid, the fact that it is a paid testimonial.

(B) Any comparison in advertisements or sales literature between investments or services must disclose all material differences between them, including (as applicable) investment objectives, costs and expenses, liquidity, safety, guarantees or insurance, fluctuation of principal or return, and tax features.

(C) All advertisements and sales literature must:

(i) prominently disclose the name of the member and may also include a fictional name by which the member is commonly recognized or which is required by any state or jurisdiction;

(ii) reflect any relationship between the member and any non-member or individual who is also named; and

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(iii) if it includes other names, reflect which products or services are being offered by the member.

This paragraph (C) does not apply to so-called "blind" advertisements used to recruit personnel.

**(e) Violation of Other Rules**

Any violation by a member of any rule of the SEC, the Securities Investor Protection Corporation or the Municipal Securities Rulemaking Board applicable to member communications with the public will be deemed a violation of this Rule 2210.

**IM-2210-1. Guidelines to Ensure That Communications With the Public Are Not Misleading**

Every member is responsible for determining whether any communication with the public, including material that has been filed with the Department, complies with all applicable standards, including the requirement that the communication not be misleading. In order to meet this responsibility, member communications with the public must conform with the following guidelines. These guidelines do not represent an exclusive list of considerations that a member must make in determining whether a communication with the public complies with all applicable standards.

(1) Members must ensure that statements are not misleading within the context in which they are made. A statement made in one context may be misleading even though such a statement could be appropriate in another context. An essential test in this regard is the balanced treatment of risks and potential benefits. Member communications should be consistent with the risks of fluctuating prices and the uncertainty of dividends, rates of return and yield inherent to investments.

(2) Members must consider the nature of the audience to which the communication will be directed. Different levels of explanation or detail may be necessary depending on the audience to which a communication is directed. Members must keep in mind that it is not always possible to restrict the audience that may have access to a particular communication with the public. Additional information or a different presentation of information may be required depending upon the medium used for a particular communication and the possibility that the communication will reach a larger or different audience than the one initially targeted.

(3) Member communications must be clear. A statement made in an unclear manner can cause a misunderstanding. A complex or overly technical explanation may be more confusing than too little information.

(4) In communications with the public, income or investment returns may not be characterized as tax-free or exempt from income tax when tax liability is merely postponed or deferred, such as when taxes are payable upon redemption.

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(5) In advertisements and sales literature, references to tax-free or tax-exempt income must indicate which income taxes apply, or which do not, unless income is free from all applicable taxes. For example, if income from an investment company investing in municipal bonds is subject to state or local income taxes, this fact must be stated, or the illustration must otherwise make it clear that income is free only from federal income tax.

(6) Recommendations

(A) In making a recommendation in advertisements and sales literature, whether or not labeled as such, a member must have a reasonable basis for the recommendation and must disclose any of the following situations which are applicable:

(i) that at the time the advertisement or sales literature was published, the member was making a market in the securities being recommended, or in the underlying security if the recommended security is an option or security future, or that the member or associated persons will sell to or buy from customers on a principal basis;

(ii) that the member and/or its officers or partners have a financial interest in any of the securities of the issuer whose securities are recommended, and the nature of the financial interest (including, without limitation, whether it consists of any option, right, warrant, future, long or short position), unless the extent of the financial interest is nominal;

(iii) that the member was manager or co-manager of a public offering of any securities of the recommended issuer within the past 12 months.

(B) The member shall also provide, or offer to furnish upon request, available investment information supporting the recommendation. Recommendations on behalf of corporate equities must provide the price at the time the recommendation is made.

(C) A member may use material referring to past recommendations if it sets forth all recommendations as to the same type, kind, grade or classification of securities made by a member within the last year. Longer periods of years may be covered if they are consecutive and include the most recent year. Such material must also name each security recommended and give the date and nature of each recommendation (e.g., whether to buy or sell), the price at the time of the recommendation, the price at which or the price range within which the recommendation was to be acted upon, and indicate the general market conditions during the period covered.

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(D) Also permitted is material that does not make any specific recommendation but which offers to furnish a list of all recommendations made by a member within the past year or over longer periods of consecutive years, including the most recent year, if this list contains all the information specified in subparagraph (C). Neither the list of recommendations, nor material offering such list, shall imply comparable future performance. Reference to the results of a previous specific recommendation, including such a reference in a follow-up research report or market letter, is prohibited if the intent or the effect is to show the success of a past recommendation, unless all of the foregoing requirements with respect to past recommendations are met.

## **IM-2210-2. Communications with the Public About Variable Life Insurance and Variable Annuities**

The standards governing communications with the public are set forth in Rule 2210. In addition to those standards, the following guidelines must be considered in preparing advertisements and sales literature about variable life insurance and variable annuities. The guidelines are applicable to advertisements and sales literature as defined in Rule 2210, as well as individualized communications such as personalized letters and computer generated illustrations, whether printed or made available on-screen.

### **(a) General Considerations**

No change to rule text.

### **(b) Specific Considerations**

#### **(1) Fund Performance Predating Inclusion in the Variable Product**

In order to show how an existing fund would have performed had it been an investment option within a variable life insurance policy or variable annuity, communications may contain the fund's historical performance that predates its inclusion in the policy or annuity. Such performance may only be used provided that no significant changes occurred to the fund at the time or after it became part of the variable product. However, communications may not include the performance of an existing fund for the purposes of promoting investment in a similar, but new, investment option (i.e., clone fund or model fund) available in a variable contract. The presentation of historical performance must conform to applicable NASD and SEC standards. Particular attention must be given to including all elements of return and deducting applicable charges and expenses.

#### **(2) Product Comparisons**

A comparison of investment products may be used provided the comparison complies with applicable requirements set forth under Rule 2210. Particular attention must be paid to the specific standards regarding "comparisons" set forth in Rule 2210(d)(2)(B).

(3) – (5) No change to rule text.

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## **IM-2210-3. Use of Rankings in Investment Companies Advertisements and Sales Literature**

### **(a) Definition of "Ranking Entity"**

For purposes of the following guidelines, the term "Ranking Entity" refers to any entity that provides general information about investment companies to the public, that is independent of the investment company and its affiliates, and whose services are not procured by the investment company or any of its affiliates to assign the investment company a ranking.

### **(b) General Prohibition**

Members may not use investment company rankings in any advertisement or item of sales literature other than (1) rankings created and published by Ranking Entities or (2) rankings created by an investment company or an investment company affiliate but based on the performance measurements of a Ranking Entity. Rankings in advertisements and sales literature also must conform to the following requirements.

### **(c) Required Disclosures**

#### **(1) Headlines/Prominent Statements**

A headline or other prominent statement must not state or imply that an investment company or investment company family is the best performer in a category unless it is actually ranked first in the category.

#### **(2) Required Prominent Disclosure**

All advertisements and sales literature containing an investment company ranking must disclose prominently:

- (A) the name of the category (e.g., growth);
- (B) the number of investment companies or, if applicable, investment company families, in the category;
- (C) the name of the Ranking Entity and, if applicable, the fact that the investment company or an affiliate created the category or subcategory;
- (D) the length of the period (or the first day of the period) and its ending date; and
- (E) criteria on which the ranking is based (e.g., total return, risk-adjusted performance).

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### (3) Other Required Disclosure

All advertisements and sales literature containing an investment company ranking also must disclose:

(A) the fact that past performance is no guarantee of future results;

(B) for investment companies that assess front-end sales loads, whether the ranking takes those loads into account;

(C) if the ranking is based on total return or the current SEC standardized yield, and fees have been waived or expenses advanced during the period on which the ranking is based and the waiver or advancement had a material effect on the total return or yield for that period, a statement to that effect;

(D) the publisher of the ranking data (e.g., "ABC Magazine, June 2003"); and

(E) if the ranking consists of a symbol (e.g., a star system) rather than a number, the meaning of the symbol (e.g., a four-star ranking indicates that the fund is in the top 30% of all investment companies).

#### (d) Time Periods

##### (1) Current Rankings

Any investment company ranking included in an item of sales literature must be, at a minimum, current to the most recent calendar quarter ended prior to use. Any investment company ranking included in an advertisement must be, at minimum, current to the most recent calendar quarter ended prior to the submission for publication. If no ranking that meets this requirement is available from the Ranking Entity, then a member may only use the most current ranking available from the Ranking Entity unless use of the most current ranking would be misleading, in which case no ranking from the Ranking Entity may be used.

##### (2) Rankings Time Periods; Use of Yield Rankings

Except for money market mutual funds:

(A) advertisements and sales literature may not present any ranking that covers a period of less than one year, unless the ranking is based on yield;

(B) an investment company ranking based on total return must be accompanied by rankings based on total return for a one year period for investment companies in existence for at least one year; one and five year periods for investment companies in existence for at least five years, and one, five and ten year periods for investment companies in existence for at least ten

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years supplied by the same Ranking Entity, relating to the same investment category, and based on the same time period; provided that, if rankings for such one, five and ten year time periods are not published by the Ranking Entity, then rankings representing short, medium and long term performance must be provided in place of rankings for the required time periods; and

(C) an investment company ranking based on yield may be based only on the current SEC standardized yield and must be accompanied by total return rankings for the time periods specified in paragraph (d)(2)(B).

**(e) Categories**

(1) The choice of category (including a subcategory of a broader category) on which the investment company ranking is based must be one that provides a sound basis for evaluating the performance of the investment company.

(2) An investment company ranking must be based only on (A) a category or subcategory created and published by a Ranking Entity or (B) a category or subcategory created by an investment company or an investment company affiliate but based on the performance measurements of a Ranking Entity.

(3) An advertisement or sales literature may not use any category or subcategory that is based upon the asset size of an investment company or investment company family, whether or not it has been created by a Ranking Entity.

**(f) Multiple Class/Two-Tier Funds**

Investment company rankings for more than one class of investment company with the same portfolio must be accompanied by prominent disclosure of the fact that the investment companies or classes have a common portfolio.

**(g) Investment Company Families**

Advertisements and sales literature may contain rankings of investment company families, provided that these rankings comply with the guidelines above, and further provided that no advertisement or sales literature for an individual investment company may provide a ranking of an investment company family unless it also prominently discloses the various rankings for the individual investment company supplied by the same Ranking Entity, as described in paragraph (d)(2)(B). For purposes of this IM-2210-3, the term "investment company family" means any two or more registered investment companies or series thereof that hold themselves out to investors as related companies for purposes of investment and investor services.

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## **IM-2210-4. Limitations on Use of NASD's Name**

### **(a) Statements of Membership**

Members may indicate NASD membership in conformity with Article XV, Section 2 of the NASD By-Laws in the following ways:

(1) in any communication with the public, provided that the communication complies with the applicable standards of Rule 2210 and neither states nor implies that NASD or any other regulatory organization endorses, indemnifies, or guarantees the member's business practices, selling methods, the class or type of securities offered, or any specific security;

(2) in a confirmation statement for an over-the-counter transaction that states: "This transaction has been executed in conformity with the NASD Uniform Practice Code."

### **(b) Certification of Membership**

Upon request to NASD, a member will be entitled to receive an appropriate certification of membership, which may be displayed in the principal office or a registered branch office of the member. The certification shall remain the property of NASD and must be returned by the member upon request of the NASD Board or its Chief Executive Officer.

## **IM-2210-7 Guidelines for Communications with the Public Regarding Securities Futures**

### **(a) NASD Approval Requirements and Review Procedures**

(1) As set forth in paragraph (c)(4) of Rule 2210, all advertisements concerning security futures shall be submitted to the Advertising Regulation Department of NASD at least ten days prior to use for approval and, if changed by NASD, shall be withheld from circulation until any changes specified by NASD have been made or, in the event of disapproval, until the advertisement has been refiled for, or has received, NASD approval.

(2) No change to rule text.

**(b) – (d)** No change to rule text.

### **(e) Projections**

Notwithstanding the provisions of Rule 2210(d)(1)(D), security futures sales literature and correspondence may contain projected performance figures (including projected annualized rates of return), provided that:

(1) – (8) No change to rule text.

**(f) – (i)** No change to rule text.

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## **IM-2210-8 Communications with the Public About Collateralized Mortgage Obligations (CMOs)**

### **(a) Definition**

For purposes of the following guidelines, the term “collateralized mortgage obligation” (CMO) refers to a multiclass debt instrument backed by a pool of mortgage pass-through securities or mortgage loans, including real estate mortgage investment conduits (REMICs) as defined in the Tax Reform Act of 1986.

### **(b) Disclosure Standards and Required Educational Material**

#### **(1) Disclosure Standards**

All advertisements, sales literature and correspondence concerning CMOs:

(A) must include within the name of the product the term “Collateralized Mortgage Obligation”;

(B) may not compare CMOs to any other investment vehicle, including a bank certificate of deposit;

(C) must disclose, as applicable, that a government agency backing applies only to the face value of the CMO and not to any premium paid; and

(D) must disclose that a CMO’s yield and average life will fluctuate depending on the actual rate at which mortgage holders prepay the mortgages underlying the CMO and changes in current interest rates.

#### **(2) Required Educational Material**

Before the sale of a CMO to any person other than an institutional investor, a member must offer to the customer educational material that includes the following:

(A) a discussion of:

(i) characteristics and risks of CMOs including credit quality, prepayment rates and average lives, interest rates (including their effect on value and prepayment rates), tax considerations, minimum investments, transaction costs and liquidity;

(ii) the structure of a CMO, including the various types of tranches that may be issued and the rights and risks pertaining to each (including the fact that two CMOs with the same underlying collateral may be prepaid at different rates and may have different price volatility); and

(iii) the relationship between mortgage loans and mortgage securities;

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(B) questions an investor should ask before investing; and

(C) a glossary of terms.

**(c) Promotion of Specific CMOs**

In addition to the standards set forth above, advertisements, sales literature and correspondence that promote a specific security or contain yield information must conform to the standards set forth below. An example of a compliant communication appears at the end of this section.

(1) The advertisement, sales literature or correspondence must present the following disclosure sections with equal prominence. The information in Sections 1 and 2 must be included. The information in Section 3 is optional; therefore, the member may elect to include any, all or none of this information. The information in Section 4 may be tailored to the member's preferred signature.

Section 1      Title - Collateralized Mortgage Obligations  
Coupon Rate  
Anticipated Yield/Average Life  
Specific Tranche - Number & Class  
Final Maturity Date  
Underlying Collateral

Section 2      Disclosure Statement:  
  
"The yield and average life shown above consider prepayment assumptions that may or may not be met. Changes in payments may significantly affect yield and average life. Please contact your representative for information on CMOs and how they react to different market conditions."

Section 3      Product Features (Optional):  
Minimum Denominations  
Rating Disclosure  
Agency/Government Backing  
Income Payment Structure  
Generic Description of Tranche (e.g., PAC, Companion)  
Yield to Maturity of CMOs Offered at Par

Section 4      Company Information:  
Name, Memberships  
Address  
Telephone Number  
Representative's Name

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## (2) Additional Conditions

The following conditions must also be met:

- (A) All figures in Section 1 must be in equal type size.
- (B) The disclosure language in Section 2 may not be altered and must be given equal prominence with the information in Section 1.
- (C) The prepayment assumption used to determine the yield and average life must either be obtained from a nationally recognized service or the member firm must be able to justify the assumption used. A copy of either the service's listing for the CMO or the firm's justification must be attached to the copy of the communication that is maintained in the firm's advertising files in order to verify that the prepayment scenario is reasonable.
- (D) Any sales charge that the member intends to impose must be reflected in the anticipated yield.
- (E) The communication must include language stating that the security is "offered subject to prior sale and price change." This language may be included in any one of the four sections.
- (F) If the security is an accrual bond that does not currently distribute principal and interest payments, then Section 1 must include this information.

## (3) Radio/Television Advertisements

(A) The following oral disclaimer must precede any radio or television advertisement in lieu of the Title information set forth in Section 1:

"The following is an advertisement for Collateralized Mortgage Obligations. Contact your representative for information on CMOs and how they react to different market conditions."

(B) Radio or television advertisements must contain the following oral disclosure statement in lieu of the legend set forth in Section 2:

"The yield and average life reflect prepayment assumptions that may or may not be met. Changes in payments may significantly affect yield and average life."

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#### (4) Standardized CMO Communication Example

##### Collateralized Mortgage Obligations

7.50% Coupon  
7.75% Anticipated Yield to 22-Year Average Life  
FNMA 9532X, Final Maturity March 2023  
Collateral 100% FNMA 7.50%

The yield and average life shown above reflect prepayment assumptions that may or may not be met. Changes in payments may significantly affect yield and average life. Please contact your representative for information on CMOs and how they react to different market conditions.

\$5,000 Minimum  
Income Paid Monthly  
Implied Rating/Volatility Rating  
Principal and Interest Payments Backed by FNMA  
PAC Bond  
Offered subject to prior sale and price change.

Call Mary Representative at (800)555-1234  
Your Company Securities, Inc., Member SIPC  
123 Main Street  
Anytown, State 12121

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## 2211. Institutional Sales Material and Correspondence

### (a) Definitions

For purposes of Rule 2210, this Rule, and any interpretation thereof:

(1) "Correspondence" consists of any written letter or electronic mail message distributed by a member to:

- (A) one or more of its existing retail customers; and
- (B) fewer than 25 prospective retail customers within any 30 calendar-day period.

(2) "Institutional Sales Material" consists of any communication that is distributed or made available only to institutional investors.

(3) "Institutional Investor" means any:

- (A) person described in Rule 3110(c)(4), regardless of whether that person has an account with an NASD member;
- (B) governmental entity or subdivision thereof;
- (C) employee benefit plan that meets the requirements of Section 403(b) or Section 457 of the Internal Revenue Code and has at least 100 participants, but does not include any participant of such a plan;
- (D) qualified plan, as defined in Section 3(a)(12)(C) of the Act, that has at least 100 participants, but does not include any participant of such a plan;
- (E) NASD member or registered associated person of such a member; and
- (F) person acting solely on behalf of any such institutional investor.

No member may treat a communication as having been distributed to an institutional investor if the member has reason to believe that the communication or any excerpt thereof will be forwarded or made available to any person other than an institutional investor.

(4) "Existing Retail Customer" means any person for whom the member or a clearing broker or dealer on behalf of the member carries an account, or who has an account with any registered investment company for which the member serves as principal underwriter, and who is not an institutional investor. "Prospective Retail Customer" means any person who has not opened such an account and is not an institutional investor.

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**(b) Approval and Recordkeeping**

**(1) Registered Principal Approval**

(A) Correspondence. Correspondence need not be approved by a registered principal prior to use, but is subject to the supervision and review requirements of Rule 3010(d).

(B) Institutional Sales Material. Each member shall establish written procedures that are appropriate to its business, size, structure, and customers for the review by a registered principal of institutional sales material used by the member and its registered representatives. Such procedures should be in writing and be designed to reasonably supervise each registered representative. Where such procedures do not require review of all institutional sales material prior to use or distribution, they must include provision for the education and training of associated persons as to the firm's procedures governing institutional sales material, documentation of such education and training, and surveillance and follow-up to ensure that such procedures are implemented and adhered to. Evidence that these supervisory procedures have been implemented and carried out must be maintained and made available to NASD upon request.

**(2) Record-keeping**

(A) Members must maintain all institutional sales material in a file for a period of three years from the date of last use. The file must include the name of the person who prepared each item of institutional sales material.

(B) Members must maintain in a file information concerning the source of any statistical table, chart, graph or other illustration used by the member in communications with the public.

**(c) Spot-Check Procedures**

Each member's correspondence and institutional sales literature may be subject to a spot-check procedure under Rule 2210. Upon written request from the Advertising Regulation Department (the "Department"), each member must submit the material requested in a spot-check procedure within the time frame specified by the Department.

**(d) Content Standards Applicable to Institutional Sales Material and Correspondence**

(1) All institutional sales material and correspondence are subject to the content standards of Rule 2210(d)(1) and the applicable Interpretive Materials under Rule 2210.

(2) All correspondence (which for purposes of this provision includes business cards and letterhead) must:

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(A) prominently disclose the name of the member and may also include a fictional name by which the member is commonly recognized or which is required by any state or jurisdiction;

(B) reflect any relationship between the member and any non-member or individual who is also named; and

(C) if it includes other names, reflect which products or services are being offered by the member.

(3) Members may not use investment company rankings in any correspondence other than rankings based on (A) a category or subcategory created and published by a Ranking Entity as defined in IM-2210-3(a) or (B) a category or subcategory created by an investment company or an investment company affiliate but based on the performance measurements of a Ranking Entity.

**(e) Violation of Other Rules**

Any violation by a member of any rule of the SEC, the Securities Investor Protection Corporation or the Municipal Securities Rulemaking Board applicable to institutional sales material or correspondence will be deemed a violation of this Rule and Rule 2210.

**2212. Telemarketing**

No change to rule text.

# Notice to Members

JULY 2003

## SUGGESTED ROUTING

Continuing Education  
Legal & Compliance  
Registration  
Senior Management

## KEY TOPICS

Foreign Deferrals  
In-Firm Delivery  
Regulatory Element

## INFORMATIONAL

### Continuing Education

The Regulatory Element Continuing Education Supervisors Program (S201) to be available July 14, 2003, at Pearson VUE centers in London and Paris; the S201 is available now for members that provide In-Firm Delivery of the Regulatory Element.

### Executive Summary

Effective July 14, 2003, the Regulatory Element Continuing Education Supervisors Program (S201) will be available at Pearson VUE centers in London and Paris. As a result, all registered principals and supervisors living in Belgium, France, Luxembourg, The Netherlands, and the UK who become required to take the S201, will no longer be eligible for a foreign deferral of the Regulatory Element. Individuals in these countries who currently have a foreign deferral will be required to meet their Regulatory Element requirement when their next anniversary window opens. Principals and supervisors living in Europe outside the above countries or in other countries outside North America remain eligible for a foreign deferral<sup>1</sup> until the S201 is available.

Effective immediately, all the Regulatory Element programs (the S101 General Program, the S106 Investment Representative Program, and the S201 Supervisors Program) are available to member firms that provide In-Firm Delivery of the Regulatory Element on firm premises.<sup>2</sup> Previously, only the S101 and S106 were available.

### Questions/Further Information

Questions about this *Notice* may be directed to Heather Bevans, Continuing Education, NASD, at (240) 386-4685.

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## Endnotes

- 1 Foreign deferral requests must be in writing, signed by a principal of the firm, and mailed or faxed to: NASD, Continuing Education Department, 9509 Key West Avenue, Rockville, MD 20850; fax: 240-386-4675. Requests must contain the individual's name, CRD number, and the city and country of residence. Firms must proactively request a foreign deferral for each anniversary date that subjects a registered person to a Regulatory Element requirement. NASD does not automatically renew foreign deferrals.
- 2 See *NASD Notice To Members 01-14*, February 2001, and *NASD Notice To Members 02-77*, November 2002.

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# Notice to Members

JULY 2003

## SUGGESTED ROUTING

Legal & Compliance  
Registered Representatives  
Senior Management

## KEY TOPICS

Fingerprint Processing Fees  
NASD By-Laws

## INFORMATIONAL

### Fingerprint Processing Fees

NASD Has Amended Section 4(b) of Schedule A to the NASD By-Laws to Increase and Establish New Fingerprint Processing Fees; **Implementation Date: July 15, 2003**

#### Executive Summary

This *Notice* supersedes NASD *Notice to Members 03-39*. NASD is issuing this *Notice* to notify members that NASD has increased the fee charged for processing each set of fingerprints submitted by a member to NASD from \$10.00 to \$13.00; and (2) established a \$13.00 fee to be charged by NASD to members that submit to NASD for posting to Web CRD fingerprint results and identifying information that have been processed through another self-regulatory organization (SRO).

NASD has also made a technical change to Section (4)(b)(4) of Section A to the NASD By-Laws to substitute the term "set of fingerprints" for "fingerprint cards."

The rule change was filed with the Securities and Exchange Commission (SEC) on July 9, 2003.<sup>1</sup> Pursuant to Section 19(b)(3)(A) of the Securities Exchange Act of 1934 (Exchange Act) and SEC Rule 19b-4(f)(2) thereunder, the rule change became immediately effective upon filing. NASD will implement the rule change on July 15, 2003.

Included with this *Notice* is Attachment A, the text of amended Section 4(b)(4) of Schedule A to the NASD By-Laws.

#### Questions/Further Information

Questions concerning this *Notice* may be directed to NASD's Gateway Call Center at (301) 590-6500.

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## Fingerprint Processing Fees

First, to help cover NASD costs associated with its fingerprinting program, NASD has increased the portion of the fee it charges to process each set of fingerprints submitted by a member to NASD from \$10.00 to \$13.00. Together with the \$22.00 fee currently charged by the FBI for fingerprint processing, the \$3.00 increase will raise the total fingerprint-processing fee from \$32.00 to \$35.00.

Second, NASD will begin assessing members a \$13.00 fee to cover NASD's cost of accepting and posting to Web CRD fingerprint results that were processed through another SRO consistent with the requirements of Section 17(f)(2) of the Exchange Act and Rule 17f-2 thereunder. According to those provisions of the Exchange Act, other SROs may process fingerprint cards for persons required to have their fingerprints processed through the FBI, consistent with fingerprint plans submitted by those SROs to the Commission, and NASD currently accepts those FBI results and posts them to Web CRD.

NASD will implement the two fee-related changes on July 15, 2003.

## Endnote

1 SR-NASD-2003-109

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## ATTACHMENT A

New language is underlined; deletions are in brackets.

### Schedule A To The NASD By-Laws

Assessments and fees pursuant to the provisions of Article VI of the By-Laws of NASD shall be determined on the following basis.

Sections 1 through 3 No change.

#### Section 4 - Fees

(a) No change.

(b) NASD shall assess each member a fee of:

(1) through (3) No change.

(4) [~~\$10.00~~] \$13.00 for processing and posting to the CRD system each set of fingerprints [fingerprint card] submitted by the member to NASD, plus any other charge that may be imposed by the United States Department of Justice for processing [such] each set of fingerprints [card].

(5) \$13.00 for processing and posting to the CRD system each set of fingerprint results and identifying information that have been processed through another self-regulatory organization and submitted by a member to NASD.

[(5)] (6) \$30.00 annually for each of the member's registered representatives and principals for system processing.

[(6)] (7) 10% of a member's final annual renewal assessment or \$100, whichever is greater, with a maximum charge of \$5,000, if the member fails timely to pay the amount indicated on its preliminary renewal statement.

(c) through (l) No change.

# Notice to Members

JULY 2003

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Registered Representatives  
Registration  
Senior Management  
Training

## KEY TOPICS

Central Registration Depository  
Form U4  
Form U5  
Statutory Disqualification

## INFORMATIONAL

### Revised Forms U4 and U5

SEC Approves Proposed Changes to Forms U4 and U5;  
Implementation Date: July 14, 2003

#### Executive Summary

The Securities and Exchange Commission (SEC) has approved changes to the Form U4 (Uniform Application for Securities Industry Registration or Transfer) and Form U5 (Uniform Termination Notice for Securities Industry Registration). The changes: (1) add new disclosure questions to the "Regulatory Disciplinary Actions" subsection of Section 14 (Disclosure Questions) of the Form U4 and a new corresponding Disclosure Reporting Page (DRP), to elicit information regarding events that might cause a person to be subject to a statutory disqualification as a result of new disqualifying events created by the Sarbanes-Oxley Act of 2002; (2) add new disclosure question Question 7F and corresponding DRP on the Form U5 to mirror Question 14J on the Form U4 relating to terminations for cause; (3) streamline the language associated with Form U4 questions relating to fingerprinting requirements; and (4) make other non-substantive technical, clarifying, and conforming revisions.

The revised forms will be implemented on July 14, 2003. Copies of the new forms are available on the NASD Web Site at [www.nasd.com](http://www.nasd.com).

Questions concerning this *Notice* may be directed to the Gateway Call Center at 301-869-6699.

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## Background And Discussion

The SEC has approved changes to the Forms that: (1) add new disclosure Question 14D(2) to the “Regulatory Disciplinary Actions” subsection of Section 14 (Disclosure Questions) of the Form U4 and a new Disclosure Reporting Page (DRP), to elicit information regarding events that might cause a person to be subject to a statutory disqualification as a result of new disqualifying events created by the passage of the Sarbanes-Oxley Act of 2002;<sup>1</sup> (2) add new disclosure question Question 7F and corresponding DRP on the Form U5 to mirror Question 14J on the Form U4 relating to terminations for cause; (3) streamline the language associated with Form U4 questions relating to fingerprinting requirements; and (4) make other non-substantive technical, clarifying, and conforming revisions generally designed to make the Forms clearer and easier to use.

This *Notice* highlights the changes made in the Forms. Additional background and explanatory information may be found in SEC Release No. 34-48161 (July 10, 2003), the SEC release approving Forms U4 and U5 revisions.<sup>2</sup>

### **New Questions 14D(2) (a) and (b) on Form U4**

The Form U4 historically has been the vehicle for reporting events that may cause a person to become subject to statutory disqualification. Accordingly, with the concurrence of a working group of regulators, including state regulators, representatives of other self-regulatory organizations (SROs), and SEC observers, NASD proposed and the SEC approved an amendment to Section 14 of the Form U4 to add Question 14D(2). New Question 14D(2) will elicit reporting of

regulatory actions that may cause an individual to be subject to a statutory disqualification under the expanded definition of disqualification in Section 15(b)(4)(H) of the Exchange Act, created by the passage of the Sarbanes-Oxley Act. Question 14D(2) requires firms to report certain orders issued by a State securities commission (or any agency or officer performing like functions), State authority that supervises or examines banks, savings associations, or credit unions, State insurance commission (or any agency or office performing like functions), an appropriate Federal banking agency (as defined in section 3 of the Federal Deposit Insurance Act), or the National Credit Union Administration (NCUA) that: bars persons from association with an entity regulated by such commission, authority, agency, or officer, or from engaging in the business of securities, insurance banking, savings association activities, or credit union activities; or constitutes a final order based on violations of any laws or regulations that prohibit fraudulent, manipulative or deceptive conduct. Former Regulatory Action Disclosure Question 14D has been renumbered as Question 14D(1). To aid members and associated persons in reporting events required to be reported under Question 14D(2), NASD has also amended the Regulatory Action DRP and added two defined terms, “final order” and “federal banking agency,” to the “Explanation of Terms” section.

Generally, a change to a disclosure question or the addition of a new disclosure question on Form U4 requires the prompt filing of an amended Form U4 only if a registered person is subject to an action or event that requires an affirmative response to the changed or new question or additional disclosure on detailed DRPs relating to the new or

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changed question. Firms making such amendments to Section 14 (Disclosure Questions) or any DRP also generally are required to complete Section 15D of the Form U4 (the Individual/Applicant's Amendment Acknowledgment and Consent). If a registered person has not been the subject of an action or event that is elicited by a changed or new disclosure question, he or she need not answer the changed or new disclosure question until an amended Form U4 filing is otherwise required (e.g., with the filing of a change of address, a request for a new registration category or license, or any new or amended responses to the questions in Section 14 or related DRPs).

Therefore, with respect to the new Question 14D(2), firms must immediately determine whether their registered persons have been subject to an action that requires reporting under the new question. **If a member firm determines that any one of its registered persons has been the subject of a regulatory action that would require a "yes" answer to Question 14D(2), it must amend that person's Form U4 to provide a "yes" answer to the appropriate subsection of Question 14D(2) not later than 30 days from implementation of the new question or August 13, 2003.** Firms must also obtain a completed Form U4 Section 15D (the Individual/Applicant's Amendment Acknowledgment and Consent) in such cases. These amendment filings must include completed DRP(s) covering the proceedings or action reported. Firms are required to maintain a copy, with original signatures, of these amendment filings.<sup>3</sup> Firms will not be required to amend a registered person's Form U4 within 30 days, *i.e.*, by August 13, 2003, if the firm has determined that the registered person is not required to answer "yes" to any part of Question 14D(2).

In sum, even though current Question 14D elicits much of the information elicited by new Question 14D(2), firms must submit any "yes" answers to Question 14D(2) by August 13, 2003, notwithstanding that previous answers to Question 14D may appear to provide the same information. In such cases, firms must also review and, as necessary, amend the previously submitted "Regulatory Action" DRP to mark the appropriate checkboxes for Question 14D(2) and make sure the details for the affirmative response to new Question 14D(2) are reported.

Firms must submit amended Forms U4 by August 13, 2003, if "yes" answers are required for any part of new Question 14D(2), and must also obtain a completed Form U4 Section 15D (the Individual/Applicant's Amendment Acknowledgment and Consent) in such cases. These amendment filings must include completed DRP(s) covering the proceedings or action reported, and firms are required to maintain a copy, with original signatures, of these amendment filings. **Any registered person for whom a firm has not filed an amended Form U4 reporting "yes" answers to Question 14D(2) by August 13, 2003, will be deemed to have represented that he or she has not been the subject of any such proceedings as of that date.**<sup>4</sup>

The CRD system will process amendments to Form U4 filings on or after July 14, 2003, as follows. As of July 14, 2003, for all registered persons who have no "yes" answers to Questions 14A through M in the Disclosure Section of the Form U4, the CRD system will default new disclosure Question 14D(2) with a "no" response for any filings prepared for submission after implementation of the new questions, and the firm will not be required to obtain an executed Section

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15D for purposes of answering Question 14D(2). Form U4 amendments filed by the firm for such individuals will not fail the completeness check because of these new questions; however, by submitting the filing, a firm will be representing that it is filing “no” answers to the new questions, unless it affirmatively changes the system-defaulted “no” answer to “yes” before submitting the filing. Similarly, as discussed above, a registered person who has not filed an amended Form U4 reporting “yes” answers to Question 14D(2) within the specified 30-day period will be deemed to have represented that he or she has not been the subject of any such proceedings.

If a registered person has answered “yes” to any question in Questions 14A through M in the Disclosure Section of the Form U4 as of July 14, 2003, the CRD system will require that a firm filing an amended Form U4 enter a response (by selecting the appropriate “yes” or “no” radio button) to new Disclosure Question 14D(2) and also obtain an executed Section 15D. If those questions are not answered at that time, the filing will fail the CRD system completeness check. In any event, firms should promptly amend Forms U4 at such time as any of their registered persons become subject to a disqualification under Section 3(a)(39) of the Exchange Act (which incorporates Section 15(b)(4)(H) by reference).<sup>5</sup>

#### **New Question 7F on Form U5**

The revised Form U5 includes a new Question 7F and corresponding DRP that mirrors Question 14J on the Form U4. Both questions concern terminations for cause. New Question 7F will enable firms to report that an individual was terminated after allegations of certain violations, fraud, wrongful taking of property, or failure to supervise.

Affirmative answers to that question will further clarify an individual’s obligation to report the termination in response to Question 14J on a subsequent Form U4. In addition, the term “resign or resigned” has been added on the Form U5 “Explanation of Terms” section to parallel the term on the Form U4.

#### **Modifications to the Form U4 Relating to Fingerprinting Requirements**

The revised Form U4 streamlines the language in Section 2 (Fingerprint Information) and Section 6 (Registration Requests with Affiliated Firms) to clarify fingerprint requirements applicable to associated persons of broker/dealers and investment adviser representatives.

Section 2 has been modified to address two situations that were not specifically covered in the March 2002 version of the Form U4. The first involves a firm submitting fingerprint results on behalf of an individual whose fingerprints were processed through another SRO, in lieu of submitting fingerprint cards. The second occurs when the firm is seeking registration for an individual who is currently employed by the firm (usually in an unregistered capacity) and previously has been fingerprinted (either through NASD or another SRO). The new language allows firms and individuals to represent that the filing firm (1) has continuously employed the individual since the last submission of a fingerprint card to NASD (and therefore is not required to resubmit a card with this filing) or (2) has continuously employed the individual since the individual had his or her fingerprints processed through another SRO, and the individual will submit (or has submitted) the processed results to the CRD system.

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The “Exceptions to the Fingerprint Requirement” subsection under Section 2 has also been modified to allow firms to select the specific permissive fingerprint exemption under Exchange Act Rule 17f-2(a)(1)(i) and/or (a)(1)(iii). The previous Form U4 language contained a general exception to the fingerprint requirement in which firms represented that an individual had been continuously employed by the filing firm in an unregistered capacity (and had previously submitted a fingerprint card in connection with that employment) or met one or more exemptions under Rule 17f-2.<sup>6</sup>

Additionally, Section 2 has been modified to clarify fingerprint filing requirements for investment adviser representative-only applicants who use the Form U4 to register with states in an investment adviser representative capacity (shown as “RA” on the Form U4). In particular, language has been added to clarify the circumstances under which an individual may need to file a fingerprint card when submitting an application for state licensure as an investment adviser representative, notwithstanding having previously submitted a fingerprint card with an unaffiliated broker/dealer. The amended language also allows an investment adviser representative to represent on the Form U4 that he or she previously satisfied a state fingerprint requirement.<sup>7</sup>

A fingerprint question also has been added to Section 6 (Registration Requests with Affiliated Firms) to create appropriate options (relating to fingerprint obligations) for individuals requesting new registrations with a firm affiliated with the filing firm.<sup>8</sup>

## Technical/Conforming Changes

The 2003 revisions include technical and other changes to increase the consistency between the Forms U4 and U5 and better clarify the disclosure information that is required to be reported on the Forms, including the following:

- ◆ Hyphens have been removed from “U-4” and “U-5” (Forms will now be referenced as “U4” and “U5.”)
- ◆ Summary fields on the DRPs (where individuals may elect to add comments on a reported event) have been reworded to emphasize that those fields are optional.
- ◆ The Customer Complaint DRPs on both Forms have been modified to clearly distinguish the fields that are required for reporting a customer complaint, arbitration claim, and/or litigation. The additional instructions and rearrangement of the questions into a more logical order clarify the information that is required to be reported on the Customer Complaint DRP; however, the content of the DRP has not changed.
- ◆ Question 14F has been revised to clarify the intent of the reporting obligation. Question 14F now asks whether an applicant has ever had an authorization to act as an attorney, accountant or federal contractor that was revoked or suspended.
- ◆ The hair and eye color codes have been modified to match the codes used by the Federal Bureau of Investigation’s fingerprint system.
- ◆ Additional bolding and underlining has been introduced to emphasize certain instructions and facilitate reporting of certain information on the DRPs.

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## Uniform Forms Reference Guide

NASD created the *Uniform Form Reference Guide* in March 2002 to provide member firms and other users of the Forms with resource and contact information. In conjunction with the 2003 revised Forms, NASD has updated and amended the *Uniform Form Reference Guide*, which is available on [www.nasd.com](http://www.nasd.com).

### Endnotes

- 1 Section 604 of the Sarbanes-Oxley Act expanded the definition of "statutory disqualification" by amending Sections 3(a)(39) and 15(b)(4) of the Securities Exchange Act of 1934 (Exchange Act).
  - 2 For additional background, see SEC Release No. 34-47936, File No. SR-NASD-2003-57, 68 FR 33545 (June 4, 2003) (proposing release).
  - 3 NASD appreciates that this requirement places an administrative burden on member firms. However, the burden should be mitigated by the following facts. First, as a practical matter, current Question 14D elicits virtually all information required by the Sarbanes-Oxley Act changes, with the exception of NCUA and state credit union regulatory proceedings or actions. Consequently, registered persons already should have reported most information responsive to the Sarbanes-Oxley Act changes, with the exception of those proceedings or actions. Based on preliminary discussions with the NCUA and state regulators, NASD believes that the number of Form U4 amendments firms will be obligated to file to report affirmative answers to new Question 14D(2) by August 13, 2003, should be quite small.
  - 4 A registered person who fails timely to notify his or her member firm of a reportable credit union regulatory proceeding will be deemed to have made a false or incomplete filing in these circumstances, irrespective of whether his or her firm has made a specific inquiry of its registered persons about such proceedings. NASD wishes to emphasize that reporting such proceedings is an affirmative obligation of the registered person, which is not excused by a firm's failure specifically to inquire as to the existence of such proceedings.
  - 5 In SEC Release No. 34-48161A, the reference to "Questions 14A through J" was corrected to read "Questions 14A through M" in these two paragraphs.
  - 6 Rule 17f-2 governs the fingerprinting requirements of securities personnel. Rule 17f-2(a)(1)(i) permits an exemption for persons who are not engaged in the sale of securities; do not regularly have access to the keeping, handling, or processing of securities, monies, or books and records; and do not have supervisory responsibility over persons engaged in such activities. Rule 17f-2(a)(1)(iii) generally exempts the partners, directors, officers, and employees of a broker/dealer that is engaged exclusively in the sales of certain securities, such as variable contracts, limited partnership interests, and unit investment trusts.
  - 7 This addition should be particularly helpful to investment adviser representatives who became licensed in a jurisdiction through the submission of a hard copy Form U4 before that jurisdiction accepted electronic filings via the Investment Adviser Registration Depository and who are now being "transitioned" onto an electronic system via an electronically filed Form U4 amendment.
  - 8 "Affiliated firm" has been added to the "Explanation of Terms" to clarify the use and meaning of that term on the Form U4.
- © 2003. NASD. All rights reserved. *Notices to Members* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

## Disciplinary and Other NASD Actions

### REPORTED FOR JULY

NASD® has taken disciplinary actions against the following firms and individuals for violations of NASD rules; federal securities laws, rules, and regulations; and the rules of the Municipal Securities Rulemaking Board (MSRB). The information relating to matters contained in this *Notice* is current as of the end of June 2003.

### Firm Expelled

**Whitehorne & Company, Ltd. (CRD #28724, Smithfield, Rhode Island)** was expelled from NASD membership. The sanction was based on findings that the firm submitted false and misleading information to NASD on a Form BD in connection with the application for a change of ownership. (NASD Case #C11020043)

### Firms Fined, Individual Sanctioned

**ESA Securities, Inc. (CRD #100320, Englishtown, New Jersey)** and **John J. Derrico (CRD #2204033, Registered Principal, Farmingdale, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$12,500. Derrico was fined \$12,500 and suspended from association with any NASD member in a principal capacity for 30 business days. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Derrico, permitted two statutorily disqualified persons to be associated with and conduct activities on behalf of the firm. The findings also stated that the firm, acting through Derrico, permitted one individual to act as a general securities representative, equity trader, and general securities principal, while failing to have registered in such capacities. NASD also found that the firm, acting through Derrico, permitted three individuals to perform duties as registered persons while their registration status with NASD was inactive due to their failure to timely complete the Regulatory Element of NASD's Continuing Education Rule. In addition, the findings state that the firm, acting through Derrico, conducted a securities business while failing to maintain its minimum net capital.

Derrico's suspension began July 7, 2003, and will conclude at the close of business August 15, 2003. (NASD Case #C9B030035)

**Omnivest, Inc. (CRD #13396, Denver, Colorado)** and **Ann Gay Phelps (CRD #714437, Registered Principal, Aurora, Colorado)** submitted a Letter of Acceptance, Waiver, and Consent in which they were fined \$10,000, jointly and severally. Phelps was also suspended from association with any NASD member as a financial and operations principal for six months. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry

of findings that the firm, acting through Phelps, submitted a FOCUS Report that was inaccurate in that it materially overstated the firm's net capital. The findings also stated that the firm, acting through Phelps, conducted a securities business while failing to maintain the required minimum net capital. NASD also found that the firm, acting through Phelps, did not make and keep current records of assets and liabilities, income, and expense and capital accounts, with proof of money balances, and did not include on its itemized daily transaction record transactions in mutual funds that were effected "application way."

Phelps' suspension began July 7, 2003, and will conclude at the close of business January 6, 2004. (NASD Case #C3A030019)

## Firms and Individuals Fined

**APS Financial Corporation (CRD #10033, Austin, Texas) and John Gerard Lindquist (CRD #1557994, Registered Principal, Austin, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$15,000, jointly and severally. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Lindquist, permitted a registered person to act in a capacity requiring registration when such person was deemed inactive for failing to complete the Regulatory Element of Continuing Education. (NASD Case #C06030008)

**Banyan Securities, LLC (CRD #22395, Larkspur, California) and Bruce Edward Neff (CRD #345627, Registered Principal, San Anselmo, California)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$15,000, jointly and severally. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Neff, allowed registered representatives to act in capacities requiring registration while they were inactive for failing to complete the Regulatory Element of Continuing Education. (NASD Case #C01030014)

**Hanmi Securities, Inc., (CRD #25518, Los Angeles, California) and Eul Hyung Choi (CRD #1592055, Registered Principal, Los Angeles, California)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$20,000, jointly and severally. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Choi, permitted registered persons, including Choi, to act in capacities requiring registration while their NASD registrations were inactive due to failure to complete in a timely manner the Regulatory Element of the Continuing Education Requirements. (NASD Case #C02030023)

**Nutmeg Securities, Ltd. (CRD #18975, Fairfield, Connecticut) and Jared David Schneid (CRD #850418, Registered Principal, Lyme, Connecticut)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$10,000, jointly and severally. In addition, the firm was fined \$13,000. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, as Market Maker ID (MMID) to the Automated Confirmation Transaction Service<sup>SM</sup> (ACT<sup>SM</sup>) acting through Schneid, reported transactions in NASDAQ National Market<sup>®</sup> (NNM<sup>®</sup>) and Consolidated Quotations Service (CQS) securities late, and also reported those transactions without using the required ".SLD" modifier. The findings also stated that the firm failed to report customer complaints and failed to file timely customer complaints pursuant to NASD Conduct Rule 3070. In addition, NASD found that the firm failed to maintain and preserve copies of customer complaints and an internal inspection report of one Office of Supervisory Jurisdiction (OSJ). Furthermore, the findings stated that the firm failed to conduct an internal inspection of one OSJ; failed to designate a registered principal in one OSJ; failed to have adequate written procedures related to customer complaint filing requirements; and failed to enforce their procedures as they related to trade reporting, internal inspections, and books and record retention. (NASD Case #C11030017)

**The (Wilson) Williams Financial Group (CRD #22704, Dallas, Texas) and Wilson Williams (CRD #834161, Registered Principal, Dallas, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$10,000, jointly and severally. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that Williams, acting for the firm, was responsible for reviewing and approving research reports for compliance with applicable federal securities laws and NASD rules, failed to adequately review sales literature written by a registered representative, and allowed the registered representative to distribute research reports that violated NASD Rule 2210(d). (NASD Case #CAF030031)

## Firms Fined

**Burlington Capital Markets Inc. (CRD #26991, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$15,000, and required to revise its written supervisory procedures concerning the handling of material, non-public information and the possible misuse of such information by employee and proprietary accounts within 30 business days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to reasonably and properly supervise the activities of its investment banking department so as to detect and prevent violations of applicable securities laws and regulations concerning the handling of

material, non-public information and the possible misuse of such information by employee and proprietary accounts. (NASD Case #CMS030119)

**J. Alexander Securities, Inc. (CRD #7809, Los Angeles, California)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$20,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed, within 90 seconds after execution, to transmit through ACT last-sale reports of transactions in OTC Equity securities, and failed to designate through ACT such last-sale reports as late. The findings also stated that the firm reported to ACT last-sale reports of transactions in OTC Equity securities on an "as of" basis when electronic submission on the trade date of such transactions was possible through ACT. Furthermore, NASD found that the firm incorrectly designated as ".SLD" through ACT last-sale reports of transactions in OTC Equity securities reported to ACT within 90 seconds of execution. (NASD Case #CMS030116)

**Paragon Capital Markets, Inc. (CRD #18555, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$35,000, and required to revise its written supervisory procedures concerning regular and rigorous reviews of execution quality, SEC Rule 15C2-11, and NASD Marketplace Rule 6740 within 30 business days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it executed short-sale orders in certain securities and failed to make an affirmative determination prior to executing such transactions. The findings stated that the firm failed to display immediately customer limit orders in NASDAQ securities in its public quotation, when each such order was at a price that would have improved the firm's bid or offer in each such security; or when the order was priced equal to the firm's bid or offer and the national best bid or offer in such security, and the size of the order represented more than a de minimis change in relation to the size associated with its bid or offer in each such security. NASD also found that the firm failed to report to ACT the correct symbol indicating whether the transaction was a buy, sell, sell short, sell short exempt, or cross for transactions in eligible securities and whether the firm executed transactions in eligible securities in a principal or agency capacity.

In addition, the findings stated that the firm accepted a transaction in ACT that contained inaccurate information and failed to report to ACT the correct execution time in transactions in eligible securities. Furthermore, NASD found that the firm published quotations for OTC Equity securities or, directly or indirectly, submitted such quotations for publication in a quotation medium (that is, the Pink Sheets L.L.C.), and: (i) did not have in its records the documentation required by SEC Rule 15c2-11(a) ("Paragraph (a) information"); (ii) did not have a reasonable basis under the circumstances for believing that the Paragraph (a) information was accurate in all material respects;

or (iii) did not have a reasonable basis under the circumstances for believing that the sources of the Paragraph (a) information were reliable. The findings also stated that, for quotations, the firm failed to file a Form 211 with NASD at least three business days before the firm's quotations were published or displayed in a quotation medium. NASD also determined that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning regular and rigorous reviews of execution quality, SEC Rule 15c2-11, and NASD Marketplace Rule 6740. (NASD Case #CMS030122)

**R. J. Thompson Securities, Inc. (CRD #100001, Omaha, Nebraska)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$12,000, and required to revise its written supervisory procedures concerning the Order Audit Trail System<sup>SM</sup> (OATS<sup>SM</sup>) within 30 business days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to timely report to OATS Reportable Order Events. The findings also stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning OATS. (NASD Case #CMS030120)

**Recom Securities, Inc. (CRD #7488, Minneapolis, Minnesota)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was fined \$27,500 and required to update its written supervisory procedures in a manner reasonably designed to ensure compliance with NASD Membership and Registration Rule 1120(a). Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it permitted registered representatives to perform duties as registered persons, including but not limited to receiving compensation for securities transactions while their registration statuses were inactive due to their failure to timely complete the Regulatory Element of NASD's Continuing Education Requirements. The findings also stated that the firm failed to establish, maintain, and enforce written supervisory procedures designed to fulfill its obligation to comply with the Regulatory Element of NASD's Continuing Education Requirements. (NASD Case #C04030030)

## Individuals Barred or Suspended

**Stanley Crawford Armour (CRD #2729805, Registered Representative, Pearl River, New York)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Armour consented to the described sanction and to the entry of findings that he purchased, or caused to be purchased, securities in the account of a public customer without the customer's knowledge or consent. The findings also stated that Armour withdrew, or caused to be withdrawn, \$72,500 from a customer's account without the customer's

knowledge or consent, and used the funds to pay for unauthorized transactions. NASD also found that Armour signed a customer's signature on an acknowledgement form without the customer's knowledge or consent. (NASD Case #C9B020091)

**Erik Antony Baron (CRD #2450380, Registered Representative, Brookfield, Connecticut)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Baron failed to testify truthfully in an NASD on-the-record interview. The findings also stated that Baron solicited a public customer to open an account with him at a member firm, requested the customer purchase shares of stock, and purchased the stock without the customer's prior knowledge, authorization, or consent. NASD also found that Baron failed to allow his member firm to review an outgoing e-mail to a customer concerning the unauthorized purchase and sent the e-mail from a non-company computer, without the firm's prior knowledge or approval. In addition, NASD found that Baron made a material misrepresentation to a customer by telling the customer that he had not intended to make the unauthorized transaction when, in fact, the order was placed intentionally. Furthermore, the findings stated that Baron failed to exercise good faith in seeking an extension of time for the customer to pay for the unauthorized transaction in violation of Regulation T of the Exchange Act. (NASD Case #C10020126)

**Simon Benjamin Bezer (CRD #2998675, Registered Representative, New York City, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$8,000, including disgorgement of \$3,000, and suspended from association with any NASD member in any capacity for two years. The fine must be paid before Bezer reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Bezer consented to the described sanctions and to the entry of findings that he issued a personal check for \$15,287 to his member firm to satisfy a margin call based on recent stock purchases in his personal account. At the time he issued this check, Bezer was aware that he did not have sufficient funds in his bank account to pay the check. The findings also stated that Bezer then sold the subject shares prior to his member firm being notified that the check had been returned for insufficient funds, earning a profit of \$3,000.

Bezer's suspension began June 16, 2003, and will conclude at the close of business June 15, 2005. (NASD Case #C9B030026)

**Michael Sean Britten (CRD #4154170, Registered Representative, Colorado Springs, Colorado)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Britten consented to the described sanction and to the entry of findings that he received a payroll check from his member firm for \$342.25. The findings stated

that Britten, without the prior authorization or knowledge of the firm, altered his payroll check and changed the amount to \$7,342.25, endorsed the altered payroll check, and deposited the altered check into a bank account in his and his wife's name, thereby converting \$7,000 from his member firm. (NASD Case #C3A030004)

**James Burling Chase (CRD #368743, Registered Representative, Milwaukee, Wisconsin)** was fined \$25,000, suspended from association with any NASD member in any capacity for one year, and ordered to requalify as a general securities representative before reentering the industry. The Securities and Exchange Commission (SEC) imposed the sanctions following the appeal of a National Adjudicatory Council (NAC) decision. The sanctions were based on findings that Chase recommended and effected transactions in a public customer's account without a reasonable basis for believing that such recommendations were suitable for the customer due to the nature of the securities, the concentration of the securities in the account, and the customer's investment objectives, financial situation, and needs.

Chase's suspension began July 7, 2003, and will conclude July 6, 2004. (NASD Case #C8A990081)

**Clifford James Chinn (CRD #2004936, Registered Representative, Los Gatos, California)** was fined \$10,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid when and if Chinn seek to reenter the securities industry. The sanctions were based on findings that Chinn entered into an agreement with public customers whereby he would use his own funds to trade in their account and apply any profits he earned from such trading to reimburse the customers' losses they had suffered in the account.

Chinn's suspension began June 2, 2003, and will conclude at the close of business June 1, 2004. (NASD Case #C01020021)

**Gary Ray Chromiak (CRD #2639493, Registered Representative, Catasauqua, Pennsylvania)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Chromiak consented to the described sanction and to the entry of findings that he participated in a scheme to benefit himself whereby another individual used his position to award insurance and health services contracts to vendors and then skimmed fees and commissions from these contract. The findings stated that Chromiak served as the insurance broker of record for the contracts and allowed the other individual to use his name to create a shell company and a bank account through which the proceeds of the fraud were laundered and concealed. (NASD Case #C9A020057)

**James Stephen Davenport (CRD #1726592, Registered Representative, Glasgow, Kentucky)** was fined \$10,000 and suspended from association with any NASD member in any capacity for nine months. The fine must be paid before Davenport reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. The NAC imposed the sanctions following the call for review of an Office of Hearing Officers (OHO) decision. The sanctions were based on findings that Davenport completed and signed "prohibited activities listing" forms wherein he falsely represented to his member firm that he had not borrowed \$1,536,000 from firm customers with which he was associated.

Davenport's suspension began March 4, 2002, and concluded December 4, 2002. (NASD Case #C05010017)

**Brian A. Duffy (CRD #3002253, Registered Representative, Rockville Centre, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Duffy recommended public customers to invest in particular stocks, instructed the customers to wire funds to pay for the stocks to a specific account held by his wife, failed to use the funds to purchase the stocks, and instead improperly used the funds, thereby converting the funds for his own use. The findings also stated that Duffy failed to respond to NASD requests for information. (NASD Case #C10020135)

**Rhonda Gail Elliott (CRD #2801768, Registered Representative, Chelsea, Michigan)** submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Elliott consented to the described sanction and to the entry of findings that she effected withdrawals totaling \$20,965 from the bank accounts of public customers maintained at the bank branch where she worked and converted \$14,195 to her own use and benefit without the knowledge or authorization of the customers. NASD also found that Elliott caused the balance to be deposited, without the knowledge or authorization of the respective customers to whom the funds belonged, to accounts from which she had made prior unauthorized withdrawals. The findings also stated that Elliott failed to respond to NASD requests for information. (NASD Case #C8A030036)

**Dane Stephen Faber (CRD #1020637, Registered Principal, Sausalito, California)** was barred from association with any NASD member in any capacity and ordered to pay \$82,220, plus interest, in restitution to public customers. The NAC imposed the sanctions following appeal of an OHO decision. The sanctions were based on findings that Faber, while soliciting public customers to purchase common stock, made material misrepresentations that the stock was being sold pursuant to an Initial Public Offering (IPO); made baseless price predictions and generalized assurances of success regarding the stock; omitted negative financial information about the issuer; and failed fully

to disclose the speculative nature of the security. The findings also stated that Faber made recommendations to a public customer that were unsuitable for her stated investment objectives.

Faber has appealed this decision to the SEC and the sanctions, except for the bar, are not in effect pending review. (NASD Case #CAF010009)

**Louis Martin Fischler (CRD #3096487, Registered Principal, Boca Raton, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$30,000 and suspended from association with any NASD member in any capacity for 45 days. The fine must be paid before Fischler reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Fischler consented to the described sanctions and to the entry of findings that he prepared a research report for a stock issuer that was unbalanced, unwarranted, and contained omissions of material fact including that the company may be required to issue securities in order to satisfy current debt, thereby diluting previously issued stock.

Fischler's suspension began July 7, 2003, and will conclude at the close of business August 20, 2003. (NASD Case #CAF030029)

**Mario Joseph Forte (CRD #2933602, Registered Principal, Staten Island, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000, including \$4,569 in disgorgement of commissions; required to pay \$11,981.60, plus interest, in restitution to a public customer; and suspended from association with any NASD member in any capacity for five months. The fine and restitution must be paid before Forte reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Forte consented to the described sanctions and to the entry of findings that he exercised control over the account of a public customer and effected numerous and excessive securities transactions in these accounts using unsuitable levels of margin in a manner that was inconsistent with the customer's investment objectives.

Forte's suspension began June 16, 2003, and will conclude November 15, 2003. (NASD Case #C9B030031)

**Donald Greg Gary (CRD #1746150, Registered Representative, Longwood, Florida)** was barred from association with any NASD member in any capacity and required to pay \$25,000 in restitution. The sanctions were based on findings that Gary received checks totaling \$25,396.59 from public customers and converted them to his own use and benefit. The findings also stated that Gary failed to respond to NASD requests for information. (NASD Case #C07020099)

**Gregory Gassoso (CRD #2873605, Registered Representative, Brooklyn, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Gassoso consented to the described sanctions and to the entry of findings that he opened accounts for public customers at his member firm without the customers' knowledge, authorization, or consent.

Gassoso's suspension began July 7, 2003, and will conclude at the close of business July 18, 2003. **(NASD Case #C10030032)**

**Darrell Todd Gibson (CRD #2833174, Registered Representative, McGregor, Texas)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Gibson engaged in a private securities transaction without prior written notice to, and approval from, his member firm. The findings also stated that Gibson recommended to public customers the purchase of a promissory note without having a reasonable basis, based on the customer's financial status, objectives, and needs. NASD also found that Gibson sold securities without being properly registered with NASD and failed to respond to NASD requests for information. **(NASD Case #C06020024)**

**James Andrew Grove (CRD #2564779, Registered Representative, Houston, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, Grove consented to the described sanctions and to the entry of findings that he exercised discretionary transactions in the account of a public customer without having obtained prior written authorization from the customer and prior written acceptance of the account as discretionary by his member firm.

Grove's suspension will begin July 21, 2003, and will conclude January 20, 2004. **(NASD Case #C05030029)**

**Sri Haran (CRD #2748909, Registered Representative, Chester, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Haran consented to the described sanctions and to the entry of findings that, while registered with a member firm, he engaged in outside business activities by referring clients to another firm for investment advisory services in exchange for a referral fee without prompt written notice to his member firm.

Haran's suspension began June 16, 2003, and concluded at the close of business June 27, 2003. **(NASD Case #C9B030033)**

**Kazi Enayet Hossain (CRD #3269002, Registered Representative, Redlands, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$3,000 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Hossain consented to the described sanctions and to the entry of findings that he participated in outside business activities for commissions without providing written notice to his member firm.

Hossain's suspension began July 7, 2003, and concluded at the close of business July 18, 2003. **(NASD Case #C02030029)**

**Richard Allen Hughey (CRD #1658128, Registered Representative, Sewickley, Pennsylvania)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Hughey consented to the described sanctions and to the entry of findings that he sold a variable life insurance contract to a public customer and received from the customer a check for \$2,000 payable to Hughey to pay a year's premium on the contract. The findings also stated that Hughey accepted the check, deposited the check into his personal bank account, and instead of immediately applying the entire amount to the customers contract, Hughey made personal use of a portion of the customer's funds. **(NASD Case #C9A030015)**

**Chet Anthony Jacks (CRD #3054197, Registered Representative, Davenport, Iowa)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Jacks consented to the described sanction and to the entry of findings that he failed to respond to NASD requests for information. **(NASD Case #C04030026)**

**Loren Revel Johnson (CRD #2823385, Registered Representative, Maplewood, Minnesota)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Johnson consented to the described sanction and to the entry of findings that he submitted fictitious expense reports totaling \$109,686.56 to his member firms and converted these funds to his own personal use and benefit. **(NASD Case #C04030027)**

**Stephen Ralph Kittelson (CRD #729924, Registered Representative, Mankato, Minnesota)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500 and suspended from association with any NASD member in any capacity for 60 days. The fine must be paid before Kittelson reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Kittelson

consented to the described sanctions and to the entry of findings that he participated in outside business activities for compensation and failed to provide prompt written notice of the transactions to his member firm. The findings also stated that Kittelson negotiated and entered into a settlement agreement with a public customer without the knowledge or consent of his member firm.

Kittelson's suspension began June 16, 2003, and will conclude at the close of business August 15, 2003. (NASD Case #C04030029)

**Dennis Ray Koenemann (CRD #2994250, Registered Representative, Ballwin, Missouri)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Koenemann consented to the described sanction and to the entry of findings that he failed to respond to NASD requests for information. (NASD Case #C04030032)

**David Ronald Krizman (CRD #1514846, Registered Representative, Tucson, Arizona)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity and ordered to disgorge \$51,407.35 in commissions in partial restitution to customers. The disgorgement must be paid before Krizman reassociates with any NASD member or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Krizman consented to the described sanctions and to the entry of findings that while associated with his member firm, he participated in outside business activities outside the scope of his employment relationship with his member firm, and failed to provide his member firm with prompt written notice. The findings also stated that Krizman failed to respond to NASD requests for information. (NASD Case #C3A030010)

**Josias Souza Lima (CRD #1374082, Registered Principal, Plymouth, Minnesota)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$25,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Lima reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Lima consented to the described sanctions and to the entry of findings that he executed unauthorized sales of securities in public customer accounts without the customers' prior knowledge, authorization, or consent.

Lima's suspension began June 16, 2003, and will conclude at the close of business December 15, 2003. (NASD Case #C04030025)

**David Carroll Loach (CRD #1251138, Registered Representative, Phoenix, Arizona)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500 and suspended from association with any NASD member in any capacity for 18 months. The fine must be paid before Loach reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Loach consented to the described sanctions and to the entry of findings that, while associated with a member firm, he participated in private securities transactions outside the regular course and scope of his association with his member firm without providing prior written notice to his member firm.

Loach's suspension began June 16, 2003, and will conclude at the close of business December 15, 2004. (NASD Case #C3A030016)

**Gerald Meyers (CRD #333324, Registered Representative, Los Angeles, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for two years. The fine must be paid before Meyers reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Meyers consented to the described sanctions and to the entry of findings that he falsified customer account forms by designating himself as the registered representative of record in connection with the solicitation of and purchase by public customers of variable universal life insurance contracts underwritten by his member firm. The findings also stated that Meyers solicited each of the contracts, and in so doing, assisted another individual to engage in the securities business without benefit of registration in contravention of NASD rules.

Meyers' suspension began July 21, 2003, and will conclude at the close of business July 20, 2005. (NASD Case #C02030032)

**Kimberly Jean Misaraca (CRD #2879704, Registered Principal, Bellport, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which she was fined \$32,500 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Misaraca reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Misaraca consented to the described sanctions and to the entry of findings that she failed to timely report customer complaints to NASD in accordance with NASD Conduct Rule 3070. The findings also stated that Misaraca failed to timely and completely respond to NASD requests for information and documentation.

Misaraca's suspension began June 16, 2003, and will conclude at the close of business June 15, 2004. (NASD Case #CLI030012)

**Francis Burke Murphy (CRD #2433976, Associated Person, Middletown, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. The suspension shall be effective immediately upon Murphy's reassociation with any NASD member. The fine must be paid before Murphy reassociates with any NASD member or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Murphy consented to the described sanctions and to the entry of findings that he engaged in the securities business of a member firm as a general securities representative and as an assistant representative for order processing, even though he was not registered with NASD in any capacity. (NASD Case #C10030035)

**Lee Francis Murphy (CRD #343318, Registered Principal, Covington, Louisiana)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$6,000, including disgorgement of commissions earned in the amount of \$367.47, and suspended from association with any NASD member in any capacity for 15 business days. Without admitting or denying the allegations, Murphy consented to the described sanctions and to the entry of findings that he effected sales of municipal securities from his firm's account to public customers at a price that was not fair and reasonable. The findings also stated that Murphy caused the distribution of municipal securities quotations that were not based upon his best judgment of the fair market value at the time he caused distribution of the quotations.

Murphy's suspension began June 16, 2003, and concluded at the close of business July 7, 2003. (NASD Case #C05030028)

**Melissa Noelle Muzzi (CRD #3016356, Registered Representative, Sacramento, California)** submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Muzzi consented to the described sanction and to the entry of findings that she forged a public customer's name to a Master Agreement to open a bank account with a line of credit and listed her own home address as the customer's address. The findings also stated that Muzzi withdrew \$7,915 against the line of credit from the account for a customer that she had opened without the customer's knowledge or consent. (NASD Case #C01030012)

**Vikram Vishweshwar Naik (CRD #3152134, Registered Representative, Brookfield, Wisconsin)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without

admitting or denying the allegations, Naik consented to the described sanction and to the entry of findings that he failed to follow the directions of a customer to invest funds in specific mutual funds for which the customer submitted a personal check; that is, without authorization or consent, Naik completed applications for variable life insurance policies and forged the names of the customer and his fiancée thereon. The findings also stated that Naik altered the name of the payee on the customer's check, forged the customer's initials to approve the alteration, and submitted the check to pay for the insurance policies. NASD also found that Naik forged the customer's signature on account transfer paperwork in order to cause the customer's mutual fund accounts to be transferred from Naik's former member firm to his new member firm. (NASD Case #C8A030038)

**Seth Paul Page (CRD #2457887, Registered Representative, Bayonne, New Jersey)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Page consented to the described sanction and to the entry of findings that he signed a public customer signature to a Client Agreement form without the customer's consent or authority. The findings also stated that Page signed a customer's signature to a letter addressed to his member firm requesting that all further account information for the customer be sent to a new address without the customer's consent or authority. NASD also found that Page executed securities transactions in the account of a public customer without the customer's knowledge, authorization, or consent. In addition, the findings stated that Page refused to answer any further questions during an NASD on-the-record interview. (NASD Case #C9B030011)

**James Lawrence Paris (CRD #1722114, Registered Principal, Daytona Beach, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500 and suspended from association with any NASD member in any principal capacity for one year. The fine must be paid before Paris reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Paris consented to the described sanctions and to the entry of findings that he failed to supervise adequately his member firm's compliance with applicable capital, record keeping, and financial reporting requirements.

Paris' suspension began June 16, 2003, and will conclude at the close of business June 15, 2004. (NASD Case #C07030031)

**Judy Ann Payer (CRD #1027554, Registered Principal, Long Beach, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which she was fined \$30,000 and suspended from association with any NASD member in any principal or supervisory capacity for 90 days. Without admitting or denying

the allegations, Payer consented to the described sanctions and to the entry of findings that she permitted persons associated with her member firm to engage in the securities business of the firm as general securities representatives and/or as assistant representatives for order processing while not registered with NASD in any capacity. The findings also stated that Payer prepared, or caused to be prepared, inaccurate records regarding the valuation of one security.

Payer's suspension began June 16, 2003, and will conclude September 13, 2003. (NASD Case #C10030029)

**Dalton Thomas Poole (CRD #2784840, Registered Representative, Tampa, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for two years. The fine must be paid before Poole reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. If Poole reassociates with any NASD member following the suspension, the member firm must adopt special supervisory procedures, for at least two years, reasonably designed to prevent the recurrence of the same or similar violations. Without admitting or denying the allegations, Poole consented to the described sanctions and to the entry of findings that he submitted a false application for a variable annuity to his member firm after he changed one owner's date of birth and the relationship between the joint contract owners without the knowledge or authorization of the clients in an attempt to circumvent underwriting standards for the variable annuity. The findings also stated that Poole submitted a confidential client account to his member firm after forging the initials of his client to the form, without the client's knowledge or authorization.

Poole's suspension began July 7, 2003, and will conclude at the close of business July 6, 2005. (NASD Case #C07030036)

**Monte Guy Pyle (CRD #2473059, Registered Representative, Poway, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$60,000 and suspended from association with any NASD member in any capacity for eight months. Without admitting or denying the allegations, Pyle consented to the described sanctions and to the entry of findings that he gave equity traders, for whom he conducted securities business, gifts that exceeded \$100 in value per individual. The findings also stated that Pyle, in connection with his request for reimbursement for the year 2000 gifts, submitted to his member firm an invoice that reflected materially misleading and inaccurate information regarding one of the gifts, and failed to submit to his member firm records reflecting separate instances in which he gave gifts and gratuities to individuals with whom he conducted business.

Pyle's suspension began July 7, 2003, and will conclude March 7, 2004. (NASD Case #C02030027)

**Kevin F. Quinn (CRD #2403509, Registered Representative, Bay Shore, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for two years. The fine must be paid before Quinn reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Quinn consented to the described sanctions and to the entry of findings that he signed the names of public customers on account documents without the customers' knowledge, authorization, or consent.

Quinn's suspension began June 16, 2003, and will conclude at the close of business June 15, 2005. (NASD Case #C10030031)

**Kenneth Harold Rodgers (CRD #2694136, Registered Representative, Milltown, New Jersey)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Rodgers, while exercising effective control over a public customer's account, recommended to the customer numerous purchase and sale transactions in various securities without having reasonable grounds for believing that such transactions were suitable for the customer in view of the size and frequency of the transactions, the nature of the account, and the customer's financial situation and needs. The findings also stated that, as a result of the transactions, the customer suffered losses. (NASD Case #C9B020088)

**Kenneth Robert Rott (CRD #1155938, Registered Representative, Golden, Colorado)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Rott consented to the described sanction and to the entry of findings that he failed to respond to NASD requests for information. (NASD Case #C3A030018)

**Timothy John Ryan (CRD #1245453, Registered Principal, Kingston, New York)** was barred from association with any NASD member in any capacity. The NAC imposed the sanction following appeal of an OHO decision. The sanction was based on findings that Ryan effected unauthorized transactions in the accounts of public customers, and that he engaged in deceptive conduct with respect to those transactions. (NASD Case #CAF010013)

**Brian Francis Schantz (CRD #1232754, Registered Principal, Bayport, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the allegations, Schantz consented to the described sanctions and to the entry of

findings that he failed to adequately supervise an individual, in that he failed to adequately investigate the following "red flags" indicating potential unauthorized trading by the individual: customer complaints, trade cancellations, and Regulation T extensions in the customer accounts of the individual.

Schantz' suspension began June 16, 2003, and concluded at the close of business July 15, 2003. (NASD Case #C9A030014)

**Stephen Wilfred Schmidt (CRD #1453836, Registered Representative, Greenwood, Indiana)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Schmidt presented a stock certificate to his member firm that was forged and counterfeit to be deposited in his margin account as collateral for a loan. The findings also stated that Schmidt failed to respond to NASD requests for information. (NASD Case #C8A020085)

**Robert Eugene Schnelle (CRD #414544, Registered Representative, Danville, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$2,500 and suspended from association with any NASD member in any capacity for one month. The fine must be paid before Schnelle reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Schnelle consented to the described sanctions and to the entry of findings that, without a public customer's knowledge and authorization, he used customer funds totaling \$10,000 received for the purchase of a security in the form of a variable annuity for his own benefit or for some purpose other than the benefit of the customer.

Schnelle's suspension began June 16, 2003, and concluded at the close of business July 15, 2003. (NASD Case #C8A030039)

**Kent David Schuette (CRD #1644804, Registered Representative, Edwardsville, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000, required to pay \$39,485, plus interest, in disgorgement of unjust profits in partial restitution to public customers, and suspended from association with any NASD member in any capacity for three months. The fine and restitution must be paid before Schuette reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Schuette consented to the described sanctions and to the entry of findings that he failed and neglected to provide prompt written notice to his member firm of his outside business activities.

Schuette's suspension began July 7, 2003, and will conclude at the close of business October 6, 2003. (NASD Case #C8A030040)

**Donald Gene Schuster (CRD #2598174, Registered Representative, Tigard, Oregon)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Schuster consented to the described sanction and to the entry of findings that he issued checks totaling \$27,198.60 drawn on an account of a club for which he was the treasurer and had control. The findings also stated that the checks were made payable to a bank account controlled by Schuster, and that he endorsed the checks and obtained possession and control of the funds withdrawn from the club's account. In addition, the findings stated that Schuster converted the \$27,198.60 to his own use and benefit, without the club's prior knowledge, authorization, or consent. NASD also found that Schuster failed to respond to NASD requests for information. (NASD Case #C3B030008)

**Randolph Frederick Simens (CRD #720948, Registered Representative, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$1,500 and suspended from association with any NASD member in any capacity for 10 business days. The fine must be paid before Simens reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Simens consented to the described sanctions and to the entry of findings that he opened a securities account with a member firm and, prior to opening the account, failed to inform, in writing, the member firm with which he was employed that he had opened the securities account. The findings also stated that Simens failed to inform, in writing, the firm with which he opened the securities account that he was associated with another member firm.

Simens' suspension began July 7, 2003, and will conclude at the close of business July 18, 2003. (NASD Case #C10030033)

**Wise Alsop Skillman, III (CRD #1757886, Registered Principal, Jacksonville, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000, suspended from association with any NASD member in a principal capacity for 30 days, and required to requalify by exam as a general securities principal within 90 days from the date of his reassociation with a member firm. If Skillman fails to requalify within the 90 days, he will be suspended from acting in a general securities principal capacity until the exam is successfully completed. The fine must be paid before Skillman reassociates with any NASD member or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Skillman consented to the described sanctions and to the entry of findings that he failed to have an adequate supervisory system in place at his member firm in that registered representatives in a branch office conducted the majority of their business with customers located in the United Kingdom during

trips to the United Kingdom, yet the firm's supervisory system provided little or no supervision of their activities at such times. The findings also stated that Skillman failed to enforce his member firm's written supervisory procedures designed to prevent violations of NASD's suitability rule. NASD also found that Skillman failed to conduct reviews of customer accounts and new account documentation for public customers at a branch office, and failed to detect that the firm's registered representatives in that office had invested a large percentage of customer assets in a single speculative security.

Skillman's suspension began July 7, 2003, and will conclude at the close of business August 5, 2003. (NASD Case #C10030036)

**John Kevin Toupin (CRD #1777676, Registered Principal, Clayton, Georgia)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Toupin received \$300,000 from a public customer for investment, deposited the funds into his account, and failed to invest the funds as instructed, thereby converting the funds to his own use and benefit. The findings also stated that Toupin failed to respond to NASD requests for information. (NASD Case #C07030001)

**Robert Tretiak (CRD #1416058, Registered Principal, Las Vegas, Nevada)** was barred from association with any NASD member in any principal capacity, suspended from association with any NASD member in any capacity for two years and six months, and fined \$25,000. The sanctions were based on findings that Tretiak fraudulently sold securities in an IPO while using a materially misleading prospectus, that he did so in violation of the contingency requirements contained in the prospectus, and that he failed properly to establish an escrow account for the IPO.

Tretiak was also fined \$10,000 for failure to satisfy a final arbitration award, and suspended until payment is made in full of the arbitration award plus an additional 30 days. It was also ordered that the suspension would convert to a bar in all capacities if the arbitration award was not paid in full within 30 months of NASD's January 23, 2001 decision in this matter.

The SEC affirmed the NAC's findings and sanctions in these two separate disciplinary proceedings that the NAC consolidated for hearing and decision.

Tretiak's suspension for the IPO transaction began June 16, 2003, and will conclude at the close of business December 15, 2005. The suspension for failure to comply with an arbitration award began May 18, 2003, and will conclude when the arbitration award is paid in full plus an additional 30 days. (NASD Cases #C02990042 and #C02980085)

**Walter Josef Tuer (CRD #2098245, Registered Representative, Costa Mesa, California)** submitted a Letter

of Acceptance, Waiver, and Consent in which he was censured, fined \$2,500, and suspended from association with any NASD member in any capacity for five business days. Without admitting or denying the allegations, Tuer consented to the described sanctions and to the entry of findings that he effected, or caused to be effected, transactions in a joint customer account, and exercised discretionary power in that account without prior written authorization from the customers and acceptance in writing by his member firm of the account as discretionary.

Tuer's suspension began July 7, 2003, and concluded at the close of business July 11, 2003. (NASD Case #C02030028)

**Chinh Viet Van (CRD #2900047, Registered Representative, San Jose, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Van consented to the described sanction and to the entry of findings that he received \$68,776.49 from public customers and converted the funds to his own use and benefit without the customers' knowledge or consent. The findings also stated that Van maintained personal securities accounts at another firm and failed to notify the account firm of his association with his member firm and failed to notify his member firm of the account. (NASD Case #C01030015)

**Gregory Beauchamp Washington, II (CRD #2691785, Registered Representative, Golden Valley, Minnesota)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity and required to pay \$25,000 in restitution, plus interest, to public customers. Satisfactory proof of payment of restitution must be made before Washington reassociates with any NASD member. Without admitting or denying the allegations, Washington consented to the described sanctions and to the entry of findings that he converted shares of stock that were to be delivered to public customers. The findings also stated that Washington failed to respond to an NASD request to appear for an on-the-record interview. (NASD Case #C04030028)

**Eugene Zlatsin (CRD #4561445, Registered Representative, Yorktown Heights, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Zlatsin reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Zlatsin consented to the described sanctions and to the entry of findings that he drafted and submitted a letter on his member firm's letterhead to a college professor that falsely represented that it had been prepared and issued by an individual stating that Zlatsin could not attend a mid-term examination because his presence was required for a business event. The findings stated that the letter

was false as the purported author of the letter was a fictitious person, and no business event requiring Zlatsin's attendance was scheduled for the date of the mid-term examination.

Zlatsin's suspension began June 16, 2003, and will conclude at the close of business June 15, 2004. (NASD Case #C9B030034)

## Individuals Fined

**Richard Hans Bach (CRD #1011097, Registered Principal, Utica, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was censured and fined \$10,000. Without admitting or denying the allegations, Bach consented to the described sanctions and to the entry of findings that he caused a member firm to be in violation of Section 15c of the Securities and Exchange Act of 1934 and Rule 15A3-1 thereunder, in that the firm used the instrumentalities of interstate commerce to conduct a securities business while failing to maintain minimum required net capital. The findings also stated that Bach, acting on behalf of a member firm, failed to designate and/or qualify a limited principal introducing broker/dealer financial and operations, as required by Membership and Registration Rule 1022c. (NASD Case #C8A030045)

**John Francis Mauldin (CRD #1945566, Registered Representative, Grapevine, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which he was censured, fined \$35,000, and required to file with NASD's Advertising Regulation Department all sales literature—except for generic newsletters that do not discuss or otherwise reference specific securities—and advertisements written, distributed, or used by him at least 10 days prior to their first use for six months. Without admitting or denying the allegations, Mauldin consented to the described sanctions and to the entry of findings that he wrote newsletters recommending hedge funds sold by a member firm that had inadequate risk disclosures about investing in the hedge funds, made an unwarranted projection of future performance, and made an inaccurate statement that a hedge fund would be subject to NASD inspection, oversight, or audit. The findings also stated that Mauldin failed to fully disclose the amount of consideration he would receive from the member firm for referring customers to the firm to buy the hedge funds. In addition, NASD found that Mauldin failed to disclose his affiliation with the member firm by name in the newsletters. (NASD Case #CAF030032)

**Gary Allen Squires (CRD #432815, Registered Representative, N. Caldwell, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was censured and fined \$11,400, including disgorgement of \$6,400 in financial benefits received by Squires. Without admitting or denying the allegations, Squires consented to the described sanctions and to the entry of findings that he exercised

discretionary authority over a securities account his wife maintained at a member firm without providing his member firm and the other firm written notification of his association with the other member. The findings also stated that Squires purchased shares of stock in five IPOs in his wife's account that traded at a premium in the secondary market. (NASD Case #C9B030038)

**Ronald James Turner (CRD #2735639, Registered Representative, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was censured and fined \$10,000. The fine must be paid before Turner reassociates with any NASD member or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Turner consented to the described sanctions and to the entry of findings that he, on behalf of his member firm, failed to ensure that the firm had properly designated a limited principal-introducing broker/dealer financial and operations as required by NASD Membership and Registration Rule 1022(c). In addition, the findings stated that Turner acted in a principal capacity without being qualified to do so. (NASD Case #C9B030030)

## Decisions Issued

The following decisions have been issued by the DBCC or the Office of Hearing Officers and have been appealed to or called for review by the NAC as of June 6, 2003. The findings and sanctions imposed in the decisions may be increased, decreased, modified, or reversed by the NAC. Initial decisions whose time for appeal has not yet expired will be reported in the next *Notice to Members*.

**Justin Edward Apgar (CRD #2770606, Registered Representative, Wall Township, New Jersey)** was fined \$52,000, including disgorgement of commissions, and suspended from association with any NASD member in any capacity for two months. The sanctions were based on findings that Apgar committed fraud by misrepresentation to a public customer in that the interest rate on an investment was guaranteed a rate of return.

This action has been appealed to the NAC, and the sanctions are not in effect pending consideration of the appeal. (NASD Case #C9B020046)

**Eric Harold Dieffenbach (CRD #1833420, Registered Principal, Littleton, Colorado)** and **Michael Antoine Rooms (CRD #2187994, Registered Principal, Littleton, Colorado)** were fined \$12,000 and \$5,000, respectively. Dieffenbach was suspended from association with any NASD member in any capacity for six months, and Rooms was suspended from association with any NASD member in any capacity for 30 business days. The sanctions were based on findings that Dieffenbach and Rooms, prior to effecting transactions in the

accounts of public customers, failed to provide any of the customers with a copy of the required Risk Disclosure Document, complete information regarding the inside bid and ask quotations, and failed to tell their customers the amount of their compensation. The findings also stated that Dieffenbach and Rooms attempted to obstruct NASD's investigation of the penny stock trading violations by contacting and bribing customers into signing non-solicitation letters, backdated and altered certain of the non-solicitation letters before submitting them to NASD, and threatened and encouraged customers to lie to NASD.

Dieffenbach and Rooms have appealed this decision to the NAC, and the sanctions are not in effect pending consideration of the appeal. (NASD Case #C06020003)

## Complaints Filed

The following complaints were issued by NASD. Issuance of a disciplinary complaint represents the initiation of a formal proceeding by NASD in which findings as to the allegations in the complaint have not been made, and does not represent a decision as to any of the allegations contained in the complaint. Because these complaints are unadjudicated, you may wish to contact the respondents before drawing any conclusions regarding the allegations in the complaint.

**Patrick W. Donohue (CRD #4168054, Registered Representative, Moreno Valley, California)** was named as a respondent in an NASD complaint alleging that he signed, or caused to be signed, the name of a public customer to effect \$6,000 in wire transfers that the customer did not authorize, deposited the funds into his bank account, and converted the funds to his own use and benefit without the customer's knowledge or consent. The complaint also alleges that Donohue failed to respond to NASD requests for information. (NASD Case #C02030030)

**Richard Peter Hveem (CRD #2622370, Registered Representative, Weehawken, New Jersey)** was named as a respondent in an NASD complaint alleging that he engaged in unauthorized trades in the account of a public customer without the customer's prior knowledge, authorization, or consent. (NASD Case #C9B030037)

**John Francis Kilcommons (CRD #2418075, Registered Representative, Quincy, Massachusetts)** was named as a respondent in an NASD complaint alleging that while registered with a member firm, he misused \$221,674.98 in insurance and brokerage customer funds and converted \$60,226.16 in customer funds for his own use and benefit without customer authorization. The complaint also alleges that Kilcommons failed to respond to NASD requests to appear for an on-the-record interview. (NASD Case #C11030018)

**Aqiyl Taariq Muhammed (CRD #2379364, Registered Representative, Marietta, Georgia)** was named as a respondent in an NASD complaint alleging that he opened an investment club at his member firm and solicited public customers to transfer \$258,263.05 from their existing securities accounts at his member firm to the investment club to be pooled for investment. The complaint also alleges that Muhammed entered into a "limited joint venture agreement" pursuant to which he obligated the investment club to invest \$350,000, and submitted wire instructions to his member firm in an attempt to send \$242,000 without conducting any investigation to determine the potential risks of the joint venture prior to entering into the agreement without having an adequate and reasonable basis for believing that the joint venture was suitable for investment prior to entering into the joint venture agreement. In addition, the complaint alleges that Muhammed entered into the agreement and failed to provide prior written notice to, and receive prior written approval from, his member firm to participate in the joint venture. (NASD Case #C07030035)

**Michael Allyn Rose (CRD #2891577, Registered Principal, Lawrence, New York)** was named as a respondent in an NASD complaint alleging that, while using the means and instrumentalities of interstate commerce to offer securities for sale, he omitted to state material facts necessary in order to make the statements made in connection with such offers, in light of the circumstances in which they were made, not misleading, and misrepresentations in the form of price predictions to induce transactions, and transactions did occur. The complaint also alleges that Rose made negligent material misrepresentations to public customers in connection with the offer and sale of a security. (NASD Case #C3A030014)

**Thomas Harris Thorp (CRD #2745965, Registered Representative, Peoria, Illinois)** was named as a respondent in an NASD complaint alleging that he received \$418,083.96 from public customers who had taken out loans on their fixed annuities at Thorp's urging. The complaint alleges that, in exchange for the loan proceeds, each customer received a promissory note from Thorp whereby the customer was promised a 10 percent guaranteed return on investments. The complaint further alleges that Thorp did not use the customer annuity loan proceeds to make investments as promised, and instead used the proceeds from the customer loans for personal use or not for the benefit of the customer. In addition, the complaint alleges that, in connection with the sales of securities, Thorp used the instrumentalities of interstate commerce or the mails to make untrue statements of material facts or omitted to state material facts necessary to make the statements, in light of the circumstances in which they were made, not misleading. Specifically, the complaint alleges that Thorp represented to public customers that their funds would be used to purchase real estate and other capital projects when, in fact, he used the customer funds for his own benefit or not for the benefit of the customer. Furthermore, the complaint alleges that Thorp

participated in private securities transactions, for compensation, by participating in the sale of securities in the form of promissory notes to public customers through a company. In connection therewith, Thorp failed and neglected to provide written notice to, and obtain written authorization from, his member firm prior to engaging in such transactions. The complaint also alleges that Thorp failed to respond to NASD requests for information. (NASD Case #C8A030043)

### **Firms Expelled for Failing to Pay Fines and/or Costs in Accordance with NASD Rule 8320**

**Hornblower & Weeks, Inc.**  
New York, New York  
(May 20, 2003)

**Investment Services Capital, Inc.**  
Haverstraw, New York  
(May 15, 2003)

**Sierra Brokerage Services, Inc.**  
Columbus, Ohio  
(May 20, 2003)

### **Firms Suspended for Failure to Supply Financial Information**

The following firms were suspended from membership in NASD for failure to comply with formal written requests to submit financial information to NASD. The action was based on the provisions of NASD Rule 8221. The date the suspension commenced is listed after the entry. If the firm has complied with the requests for information, the listing also includes the date the suspension concluded.

**Davrey Financial Services, Inc.**  
Tacoma, Washington  
(May 19, 2003)

**Euronet Securities Corp.**  
Madrid, Spain  
(May 19, 2003)

**Lee Harris and Company**  
Chicago, Illinois  
(June 4, 2003)

**Oakdale Financial Group, LLC**  
New York, New York  
(June 4, 2003)

**Peyton, Chandler & Sullivan, Inc.**  
Roseville, California  
(May 19, 2003 – June 12, 2003)

### **Suspension Lifted**

NASD has lifted the suspension from membership on the date shown for the following firm because it has complied with formal written requests to submit financial information.

**Elephantx Online Securities, LLC**  
New York, New York  
(May 8, 2003)

### **Individuals Barred Pursuant to NASD Rule 9544 for Failure to Provide Information Requested Under NASD Rule 8210**

(The date the bar became effective is listed after the entry.)

**Banda, James C.**  
Sagamore Hills, Ohio  
(May 13, 2003)

**Chan, Brian**  
San Diego, California  
(June 2, 2003)

**Cope, Jason**  
Coraopolis, Pennsylvania  
(May 27, 2003)

**Curry, Richard H.**  
Sugarland, Texas  
(May 15, 2003)

**Harris, James Sheridan**  
Duncanville, Texas  
(June 3, 2003)

**Holmes, Leslie R.**  
Upper Marlboro, Maryland  
(June 2, 2003)

**Vivono, Anthony S.**  
Lansdale, Pennsylvania  
(May 27, 2003)

**Waye, II, Gary C.**  
Rochester, New York  
(June 5, 2003)

## **Individuals Suspended Pursuant to NASD Rule 9541(b) for Failure to Provide Information Requested Under NASD Rule 8210**

(The date the suspension began is listed after the entry. If the suspension has been lifted, the date follows the suspension date.)

**Liao, Lewis**  
Ranch Palos Verdes, California  
(June 2, 2003)

**Lombardi, Ralph M.**  
Marmora, New Jersey  
(May 23, 2003)

**Lou, Albert**  
Monterey Park, California  
(May 30, 2003)

**Luetje, Kevin M.**  
Sarasota, Florida  
(May 23, 2003)

**Micciche, Anthony V.**  
Tampa, Florida  
(June 5, 2003)

**Wise, Stanley M.**  
Newport Beach, California  
(May 27, 2003)

## **Individuals Revoked for Failing to Pay Fines and/or Costs in Accordance with NASD Rule 8320**

**Ballon, Robert I.**  
San Diego, California  
(May 15, 2003)

**Bruzzese, Michael**  
Brooklyn, New York  
(May 15, 2003)

**Eckstein, Brian K.**  
Johnstown, Ohio  
(May 20, 2003)

**Haburjak, David W.**  
W. Gastonia, North Carolina  
(May 15, 2003)

**Koch, Robert**  
Newtropli, Pennsylvania  
(May 15, 2003)

**Mormando, Jr., Nicholas J.**  
Brooklyn, New York  
(May 15, 2003)

**Morris, Aaron S.**  
Hollywood, Florida  
(May 15, 2003)

**Rice, Jay R.**  
Salt Lake City, Utah  
(May 15, 2003)

**Stachura, Jerome L.**  
Bensalem, Pennsylvania  
(May 15, 2003)

**Stevens, Jason B.**  
Scottsdale, Arizona  
(May 15, 2003)

## **Individual Suspended Pursuant to NASD Rule Series 9510 for Failure to Comply With an Arbitration Award or a Settlement Agreement**

**Correa, Osualdo E.**  
Corpus Christi, Texas  
(May 15, 2003)

## **NASD Charges Former Merrill Lynch Managing Director with Issuing Misleading Research, Selectively Disclosing Material Non-Public Information, and Improper Gift Giving to Tyco's CEO**

NASD charged Phua Young, formerly a managing director and senior research analyst at Merrill Lynch, with a series of research violations, including publishing research reports about Tyco International Ltd., that contained misleading statements and exaggerated claims. The misconduct, which included other related securities violations, took place over a three-year period until April 2002, when Merrill discharged him for violating firm policy and regulatory standards.

The charges filed represent another chapter in NASD's actions involving research analyst misconduct. In the last year, NASD has brought over 20 actions involving violations against firms and individuals.

This complaint focuses primarily on Young's coverage of Tyco, Young's favored company and the most important issuer in Young's research area. From February until April 2002, Young published research reports about Tyco that contained misleading statements and exaggerated claims that were contrary to the beliefs, views, and opinions he expressed privately. Young also disseminated material non-public information about Tyco and gave advance notice of proposed ratings to selected institutional clients. The complaint further charges that Young routinely gave Tyco advance copies of his research reports that included proposed ratings and analyses. NASD also charged Young with improperly giving a gift to Dennis Kozlowski, then Tyco's chief executive officer.

"The conduct of this analyst, as evidenced by his own e-mails, gifts to the CEO of Tyco, and favors he received from the company amounted to a betrayal of objectivity and honesty in research," said Mary L. Schapiro, NASD Vice Chairman and President of Regulatory Policy and Oversight. "NASD will continue to hold analysts accountable whenever the interests of issuers and investment bankers cause them to lose their objectivity and produce misleading and skewed research."

While at Merrill Lynch, Young maintained an extraordinarily close relationship to Tyco, as evidenced by his own e-mails that manifest his lack of independence from the company. For instance, Young remarked to a senior employee in Tyco's Investor Relations Department, "I am indirectly paid by Tyco." In another e-mail following Young's blast voice mail to institutional clients, Young asked Tyco Investor Relations, "[d]id I not sound pumped up enough?" Tyco responded "you always sound pumped."

Young's close relationship with Tyco is also evident from favors he received from Tyco. For example, Young flew multiple times on one of Tyco's corporate jets for business trips, often accompanied by Kozlowski. On another occasion, Young requested, and Tyco retained, a private investigator to prepare a background report on one of Young's personal friends. Young's close relationship with Tyco compromised his independence as a research analyst.

### **Misleading Research Reports**

The complaint stated that in January 2002 Tyco announced it planned to split into four companies and retire \$11 billion in debt. As part of this plan, Tyco announced it would spin off CIT, a large commercial lender. In February, March, and April of 2002, Young published a series of research reports on Tyco in which he assumed a sale of CIT for \$8 billion, relied upon that sale price to reach an asset valuation of the company between \$60 to \$70 per share, and stated that the stock was undervalued. Privately, however, Young did not believe that the CIT sale would produce \$8 billion or anywhere near that number, as noted in his e-mails. Young also privately expressed his negative view of Tyco's debt level, and believed the company was facing a liquidity crisis and that the stock was overvalued. For example,

when the stock was trading between \$33 and \$35 per share, in an e-mail dated March 7, 2002, to a Tyco investor relations employee, Young stated:

"I am waiting for \$10 [stock price] after tyco [sic] announces the inability to sell CIT for anything near \$8B. Liquidity crunch, more distractions, the debt bomb starts to TICK, TICK, TICK . . . ."

Several days earlier, he expressed a similar concern to the same employee:

"Dennis sounds down. He does not sound like he can sell CIT without a huge loss."

Although Tyco did not ultimately pursue the larger break-up plan, it spun off CIT in July 2002 for only \$4.6 billion, not the \$8 billion noted in Young's research reports.

### **Improperly Sharing Research and Ratings**

The complaint further charges that Young gave advance notice of unpublished ratings to institutional clients. Before Young re-initiated coverage of Tyco and another company in September 1999, he selectively disclosed to certain institutional clients that he was going to give Tyco and the other company Merrill's highest rating. Given his close relationship with Tyco, he also routinely gave the company advance notice of unpublished research reports and ratings, solicited Tyco to make changes, and generally followed the company's suggested edits. For example, in one e-mail, Young forwarded a draft report and proposed rating to Tyco's chief financial officer, stating:

PLEASE REVIEW ASAP. I WILL NOT SEND OUT UNTIL I HEAR FROM YOU FIRST! LOYAL TYCO EMPLOYEE!

### **Dissemination of Material Non-Public Information**

The complaint charges that in September 1999, Young improperly disseminated material non-public information to selected institutional clients concerning Tyco's acquisition of a Siemens business unit for over \$1 billion in cash. As noted in the complaint, Young also received a "grid" detailing the advantages of the Siemens acquisition from a Tyco investor relations employee. That same day, he received an e-mail from Tyco that stated:

"The attached information makes you an insider until the deal is announced. The information sheet at this stage is preliminary."

Shortly thereafter, Young e-mailed the "grid" to an institutional client and wrote, "You can't use until after announcement." The next day, Tyco advised Young, "DO NOT PUT OUT ANY INFORMATION UNTIL THE STORY CROSSES THE WIRE."

### **Improper Gift to Dennis Kozlowski, Tyco's CEO**

NASD also charged that in December 2001, Young violated NASD rules when he gave a case of wine valued at over \$4,500 to Kozlowski. NASD rules prohibit a registered person from giving gifts valued at over \$100 to any person where such payment is in relation to the business of the employer of recipient.

Under NASD rules, Young may file a response and request a hearing before an NASD hearing panel. Possible sanctions include a fine, suspension, bar, or expulsion from NASD.

### **NASD Takes Disciplinary Actions for Variable Annuity Abuses and Issues Investor Alert on Variable Products**

NASD, as part of its ongoing efforts to curb abuses in the sale of variable products, has censured and fined InterSecurities, Inc., of St. Petersburg, Florida, \$125,000 for having inadequate procedures and systems governing its sale of variable products and its handling of customer complaints. In addition, in three separate enforcement actions not related to the InterSecurities matter, NASD announced that it filed complaints against individuals for unsuitable sales of deferred variable annuities.

"There has been a dramatic increase in sales of variable products in the last several years and the marketing efforts used by some variable annuity sellers deserve scrutiny—especially when seniors are the targeted investors," said Mary L. Schapiro, NASD Vice Chairman and President of Regulatory Policy and Oversight. "Sales pitches that confuse or frighten investors violate NASD rules and will be the subject of enforcement action." For this reason, NASD today issued an Investor Alert to help investors better understand variable annuities before purchasing one. The alert, *Variable Annuities: Beyond the Hard Sell*, can be found at [www.nasdr.com/alert\\_variable\\_annuities.htm](http://www.nasdr.com/alert_variable_annuities.htm).

InterSecurities was charged with failing to adequately address customer complaints that were made against it. As an affiliate company of InterSecurities, Western Reserve Life Assurance Co., of Ohio (WRL) received nearly all customer complaints concerning InterSecurities' sales of variable products. Because WRL determined whether each was a "complaint," InterSecurities failed to have records of all complaints and report them to NASD as required by NASD rules.

InterSecurities also did not have procedures in place to ensure the proper registration, training, or supervision of individuals that handled customer complaints, adequate guidelines for customer complaint investigations, or adequate reviews of its complaint handling process. In addition, over the course of more than four years, InterSecurities had inadequate procedures and systems governing the sale of variable products. In settling these matters, InterSecurities neither admitted nor denied NASD's findings.

In other recent enforcement actions, NASD filed three separate complaints against individuals for unsuitable sales of variable annuities. They include:

- ♦ Ralph T. Grubb, at the time employed by Banc of America Investment Services, Inc., was charged with an unsuitable sale of a deferred variable annuity to an 18-year-old high school senior who was seeking a safe investment for a \$30,000 legacy while in college. When she graduated from college, she intended to use the funds for a down payment on a house or to buy a car. However, the annuity contract was subject to a ten percent additional tax on distributions prior to age 59½ and carried surrender charges that would have still been in effect when she intended to liquidate her investment. The complaint also alleges that Grubb's recommended allocation of 100 percent of the customer's premium to one equity sub-account within the annuity was unsuitable in relation to the customer's risk tolerance, and that the customer had no need for the death benefit feature of the annuity because she was unmarried and had no dependents. Moreover, the customer was in the lowest marginal tax bracket and had no need for tax deferral, a principal reason that people purchase variable annuities. The complaint further alleges that Grubb made an unsuitable sale of a deferred variable annuity to the customer's father for the investment of a legacy received by the customer's 16-year-old sister.
- ♦ Kevin S. Jones was charged with an unsuitable switch of variable annuities. At the time, Jones was employed at Raymond James and Associates, Inc. The customer, a self-employed rancher, needed access to her funds and had an investment time horizon of two to seven years. During the sixth year of her ownership of a \$300,000 variable annuity, Jones recommended that she switch to another variable annuity in the amount of \$315,000, for which Jones received a commission of \$8,500. The original variable annuity would have allowed the customer penalty-free access to her money in eight months, but the switch resulted in limited access to her investment for the next nine years. The switch also caused the customer to pay a \$1,600 surrender fee. The complaint further alleges that the switch resulted in no significant improvement in the death benefit for the customer and caused the customer to pay substantial increased annual costs. Over a six-year period, these increased costs depleted the \$15,000 bonus offered by the second variable annuity.
- ♦ Gregory Hunter of Edward Jones, Inc., was named in the third action and charged with an unsuitable sales transaction. In this case, the customer had a portfolio worth approximately \$250,000 that generated monthly income averaging approximately \$1,500. Hunter recommended and sold to this customer a \$60,000 deferred variable annuity by liquidating a portion of her portfolio. The net effect of the transaction was that the customer's portfolio now

generated monthly income that was insufficient to cover her monthly expenses requiring the customer to make regular monthly withdrawals of \$360 from the annuity for living expenses. Given the customer's need for current income and the fact that she did not need benefits offered by a variable annuity such as tax deferral or a death benefit, the transaction was unsuitable.

Under NASD rules, individuals and firms named in complaints can file a response and request a hearing before an NASD disciplinary panel. Possible sanctions include a fine, suspension, bar, or expulsion from NASD.

These cases are the latest in a series of special examinations conducted by NASD that focused on the sale of variable contracts.

NASD has issued alerts to both firms and investors to help ensure that these products are properly sold, which can be found at:

- ◆ [www.nasdr.com/alert\\_exchange\\_lifeinsurance.htm](http://www.nasdr.com/alert_exchange_lifeinsurance.htm),
- ◆ [www.nasdr.com/pdf-text/9935ntm.pdf](http://www.nasdr.com/pdf-text/9935ntm.pdf), and
- ◆ [www.nasdr.com/pdf-text/0044ntm.pdf](http://www.nasdr.com/pdf-text/0044ntm.pdf).